UMPQUA HOLDINGS CORP
Form 10-Q
August 07, 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: June 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: 57,777,868 shares outstanding as of July 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)

	June 30, 2006	December 31, 2005
ASSETS		
Cash and due from banks	$ 176,983	$ 151,521
Temporary investments	61,981	10,233
Total cash and cash equivalents	238,964	161,754
Trading account assets	376	601
Investment securities available for sale, at fair value	692,910	671,868
Investment securities held to maturity, at amortized cost	9,676	8,677
Mortgage loans held for sale	31,118	9,061
Loans	5,296,720	3,921,631
Allowance for loan losses	(58,516)	(43,885)
Net loans	5,238,204	3,877,746
Restricted equity securities	20,538	14,263
Premises and equipment, net	100,040	88,865
Goodwill and other intangible assets, net	682,789	408,503
Mortgage servicing rights, net	11,550	10,890
Other assets	153,778	108,411
Total assets	$ 7,179,943	$ 5,360,639
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits		
Noninterest bearing	$ 1,264,249	$ 987,714
Interest bearing	4,200,521	3,298,552
Total deposits	5,464,770	4,286,266
Securities sold under agreements to repurchase and federal funds purchased	261,720	113,865
Term debt	57,081	3,184
Junior subordinated debentures	204,222	165,725
Other liabilities	79,050	53,338
Total liabilities	6,066,843	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: 57,651,533 in 2006 and 44,556,269 in 2005	923,309	564,579
Retained earnings	208,335	183,591
Accumulated other comprehensive loss	(18,544)	(9,909)
Total shareholders equity	1,113,100	738,261
Total liabilities and shareholders equity	$ 7,179,943	$ 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 June 30,		Six months ended June 30,	
	2006	**2005**	**2006**	**2005**
INTEREST INCOME				
Interest and fees on loans	$ 86,004	$ 60,220	$ 159,124	$ 117,156
Interest and dividends on investment securities				
Taxable	6,693	6,252	13,404	12,801
Exempt from federal income tax	836	699	1,558	1,412
Dividends	56	38	100	81
Other interest income	354	454	503	687
Total Interest Income	93,943	67,663	174,689	132,137
INTEREST EXPENSE				
Interest on deposits	25,953	13,485	46,991	24,809
Interest on securities sold under agreements to repurchase and federal funds purchased	1,802	407	4,191	908
Interest on term debt	2,055	139	2,083	544
Interest on junior subordinated debentures	3,376	2,550	6,388	4,944
Total interest expense	33,186	16,581	59,653	31,205
Net interest income	60,757	51,082	115,036	100,932
Provision for loan losses	54	1,400	75	2,400
Net interest income after provision for loan losses	60,703	49,682	114,961	98,532
NON-INTEREST INCOME				
Service charges on deposit accounts	6,450	5,426	11,934	10,248
Brokerage commissions and fees	2,534	2,879	4,902	6,008
Mortgage banking revenue, net	2,503	228	4,347	1,578
Net (loss) gain on sale of investment securities	(1)	1,398	(1)	1,398
Other income	2,320	1,993	4,826	3,294
Total non-interest income	13,806	11,924	26,008	22,526
NON-INTEREST EXPENSE				
Salaries and employee benefits	23,337	20,361	45,138	40,640
Net occupancy and equipment	7,199	6,109	14,367	12,242
Communications	1,480	1,578	2,945	2,823
Marketing	1,491	1,310	2,816	2,067
Services	3,414	2,835	6,817	6,347
Supplies	722	710	1,351	1,237
Intangible amortization	791	660	1,338	1,320

Merger related expenses	1,656	161	1,907	262
Other expenses	3,153	2,697	5,544	4,918
Total non-interest expenses	43,243	36,421	82,223	71,856
Income before income taxes	31,266	25,185	58,746	49,202
Provision for income taxes	11,635	9,179	21,688	18,177
Net income	$ 19,631	$ 16,006	$ 37,058	$ 31,025
Basic earnings per share	$ 0.40	$ 0.36	$ 0.80	$ 0.70
Diluted earnings per share	$ 0.40	$ 0.36	$ 0.79	$ 0.69

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			37,058		37,058
Other comprehensive loss, net of tax:					
Unrealized losses on securities arising during the year (2)				(8,635)	(8,635)
Comprehensive income					$ 28,423
Stock-based compensation		1,019			1,019
Stock repurchased and retired	(48)	(1)			(1)
Issuances of common stock under stock plans and related tax benefit	349,983	3,991			3,991
Stock issued in connection with acquisitions	12,745,329	353,721			353,721
Cash dividends ($0.24 per share)			(12,314)		(12,314)
Balance at June 30, 2006	57,651,533	$ 923,309	$ 208,335	$ (18,544)	$ 1,113,100

(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 loss on securities of $8.6 million (net of $5.4 million tax benefit), plus reclassification adjustment for net gains 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 June 30,		Six months ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 19,631	$ 16,006	$ 37,058	$ 31,025
Unrealized (losses) gains arising during the period on investment securities available for sale	(10,407)	8,390	(14,010)	(1,150)
Reclassification adjustment for losses (gains) realized in net income, net of tax (expense of $559 for the three and six months ended June 30, 2005)	1	(839)	1	(839)
Income tax benefit (expense) related to unrealized losses/gains on investment securities, available for sale	4,088	(3,356)	5,374	460
Net unrealized (losses) gains on investment securities available for sale	(6,318)	4,195	(8,635)	(1,529)
Comprehensive income	$ 13,313	$ 20,201	$ 28,423	$ 29,496

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

(in thousands)

	Six months ended June 30, 2006	Six months ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 37,058	$ 31,025
Adjustments to reconcile net income to net cash provided by operating activities of continuing operations:		
Federal Home Loan Bank stock dividends	(100)	(81)
Deferred income tax benefit	(264)	
Amortization of investment premiums, net	572	518
Origination of loans held for sale	(133,339)	(146,221)
Proceeds from sales of loans held for sale	112,889	147,207
Net decrease in trading account assets	270	174
Provision for loan losses	75	2,400
Gain on sales of loans	(388)	(496)
Loss (gain) on sale of investment securities available-for-sale	1	(1,398)
(Increase) decrease in mortgage servicing rights	(1,301)	917
Depreciation and amortization	5,719	5,607
Tax benefits of stock options exercised	187	1,592
Net decrease (increase) in other assets	37,518	(47,323)
Net decrease in other liabilities	(610)	(177)
Other, net	484	271
Net cash provided by operating activities	58,771	(5,985)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available-for-sale		(634)
Sales and maturities of investment securities available-for-sale	37,998	103,779
Redemption of Federal Home Loan Bank stock	87	41
Maturities of investment securities held-to-maturity	1,850	75
Net loan and lease originations	(386,523)	(157,006)
Purchase of loans	(15,245)	(3,904)
Disposals of furniture and equipment	37	40
Cash acquired in merger, net of cash consideration paid	36,950	
Proceeds from sales of loans	50,437	15,052
Purchases of premises and equipment	(5,677)	(6,966)
Net cash used by investing activities	(280,086)	(49,523)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposit liabilities	162,704	174,242
Net increase in Fed funds purchased	145,000	47,000

Net increase (decrease) in securities sold under agreements to repurchase	2,855	(7,818)
Dividends paid on common stock	(10,732)	(2,672)
Excess tax benefits from the exercise of stock options	752	
Proceeds from stock options exercised	3,052	3,601
Retirement of common stock	(1)	(1,149)
Repayment of term debt	(5,105)	(75,155)
Net cash provided by financing activities	298,525	138,049
Net increase in cash and cash equivalents	77,210	82,541
Cash and cash equivalents, beginning of period	161,754	118,207
Cash and cash equivalents, end of period	$ 238,964	$ 200,748
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 58,345	$ 28,170
Income taxes	$ 19,458	$ 12,674

See notes to condensed consolidated financial statements

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 six months ended June 30, 2006 reflected the following changes:

(in thousands, except per share data)

	Three months ended	**Six months ended June 30, 2006**

	June 30, 2006	
	Increase/(Decrease)	
Salaries and employee benefits	$ 344	$ 698
Income before income taxes	$ (344)	$ (698)
Provision for income taxes	$ (138)	$ (279)
Net income	$ (206)	$ (419)
Basic earnings per share	$ 0.00	$ 0.00
Diluted earnings per share	$ 0.00	$ (0.01)

The compensation cost related to stock options that has been charged against income (included in salaries and employee benefits) was $355,000 and $721,000 for the three and six months ended June 30, 2006, respectively, as compared to $14,000 and $30,000 for the same periods in 2005, respectively. This cost includes incremental expense resulting under SFAS No. 123R as well as costs related to unvested options assumed in connection with acquisitions as described below. The total income tax benefit recognized in the income statement related to stock options was $142,000 and $288,000 for the three and six months ended June 30, 2006, respectively, as compared to $6,000 and $12,000 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 June 30, 2006.

	Six months ended June 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 six months ended June 30, 2005. Compensation cost, net of tax, of $8,000 and $18,000, was recognized as salaries and benefits expense for the three and six months ended June 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 six months ended June 30, 2005:
(in thousands, except per share data)

	Three months ended June 30, 2005	**Six months ended June 30, 2005**
NET INCOME, AS REPORTED	$ 16,006	$ 31,025
Deduct: Additional stock-based employee compensation determined under the fair value based method for all awards, net of tax effects	(113)	(215)
Pro forma net income	$ 15,893	$ 30,810
NET INCOME PER SHARE:		
Basic as reported	$ 0.36	$ 0.70
Basic pro forma	$ 0.36	$ 0.69
Diluted as reported	$ 0.36	$ 0.69
Diluted pro forma	$ 0.35	$ 0.69

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:

	Three months ended June 30, 2005	Six months ended June 30, 2005
Dividend yield	1.66%	1.66%
Expected life (years)	7.5	7.5
Expected volatility	38%	38%
Risk-free rate	4.04%	4.20%
Weighted average grant date fair value of options granted	$ 8.90	$ 9.41

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

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(In thousands, except per share data)

	Six months ended June 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	(348)	$ 8.78		
Forfeited/expired	(18)	$ 17.87		
Balance, end of period	2,228	$ 14.85	6.32	$ 24,178
Options exercisable at end of period	1,666	$ 12.62	5.80	$ 21,718

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 six months ended June 30, 2006 was $3.0 million and $6.3 million, respectively. This compared to the total intrinsic value of options exercised during the three and six months ended June 30, 2005 of $946,000 and $4.6 million, respectively. During the three and six months ended June 30, 2006, the amount of cash received from the exercise of stock options was $1.8 million and $3.1 million, respectively. As of June 30, 2006, there was $3.8 million of total unrecognized compensation cost related to non-vested stock options which is expected to be recognized over a weighted-average period of 3.1 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 June 30, 2006 and changes for the six months ended June 30, 2006:

(In thousands, except per share data)

	Six months ended June 30, 2006	
	Restricted Shares Outstanding	Average Grant Date Fair Value
Balance, beginning of period	47	$ 20.77
Granted	91	$ 27.98
Vested		
Forfeited/expired	(4)	$ 22.20
Balance, end of period	134	$ 25.62

The compensation cost related to restricted stock that has been charged against income (included in salaries and employee benefits) was $195,000 and $298,000 for the three and six months ended June 30, 2006, respectively, as compared to $55,000 and $120,000 for the same periods in 2005, respectively. The total income tax benefit recognized in the income statement related to restricted stock was $78,000 and $119,000 for the three and six months ended June 30, 2006, respectively as compared to $22,000 and $48,000 for the same periods in 2005, respectively. The total fair value of shares vested during the three and six months ended June 30, 2006 was $8,000. This compared to total fair value of shares vested during the three and six months ended June 30, 2005 of $5,000 and $18,000, respectively. As of June 30, 2006, there was $3.1 million of total unrecognized compensation cost related to non-vested restricted stock which is expected to be recognized over a weighted-average period of 4.0 years.

For the three months ended June 30, 2006 and 2005, the Company received income tax benefits of $749,000 and $259,000, 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 six months ended June 30, 2006 and 2005, the Company received income tax benefits of $1.9 million and $1.6 million, respectively. Prior to the adoption of SFAS No. 123R, the Company presented all tax benefits of deductions 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 $752,000.

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 has 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 $14.32 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 June 30, 2006, the goodwill asset recorded in connection with the Western Sierra acquisition was $247.8 million.

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 three and six-month month periods ended June 30, 2006 and 2005.

The following tables present unaudited pro forma results of operations for the three and six months ended June 30, 2006 and 2005 as if the acquisition of Western Sierra had occurred on January 1, 2005. The Company 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 revenue enhancements or cost savings. The pro forma results have been prepared

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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)

	Three Months Ended June 30, 2006			
	Umpqua	**Western Sierra**	**Pro Forma Adjustments**	**Pro Forma Combined**
Net interest income	$60,757	$10,390	$1,729(a)	$72,876
Provision for loan losses	54	350		404
Non-interest income	13,806	1,889		15,695
Non-interest expense	43,243	7,619	(968)(b)	49,894
Income before income taxes	31,266	4,310	2,697	38,273
Provision for income taxes	11,635	1,708	1,079(c)	14,422
Net income	$19,631	$ 2,602	$1,618	$23,851
Earnings per share:				
Basic	$ 0.40			$ 0.42
Diluted	$ 0.40			$ 0.41
Average shares outstanding:				
Basic	48,529	5,466	3,334(d)	57,329
Diluted	48,994	5,584	3,406(d)	57,984

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

(b) Consists of merger related expenses of $1.7 million, partially offset by core deposit intangible amortization of $688,000.

(c) Income tax effect of pro forma adjustments at

40%.

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

(in thousands, except per share data)

	Six Months Ended June 30, 2006			
	Umpqua	Western Sierra	Pro Forma Adjustments	Pro Forma Combined
Net interest income	$115,036	$25,834	$3,510(a)	$144,380
Provision for loan losses	75	350		425
Non-interest income	26,008	5,040		31,048
Non-interest expense	82,223	18,168	(531)(b)	99,860
Income before income taxes	58,746	12,356	4,041	75,143
Provision for income taxes	21,688	4,898	1,616(c)	28,202
Net income	$ 37,058	$ 7,458	$2,425	$ 46,941
Earnings per share:				
Basic	$ 0.80			$ 0.82
Diluted	$ 0.79			$ 0.81
Average shares outstanding:				
Basic	46,604	6,638	4,049(d)	57,291
Diluted	47,112	6,812	4,155(d)	58,079

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

(b) Consists of merger related expenses of $1.9 million, partially offset by core deposit intangible amortization of $1.4 million.

(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)

	Three Months Ended June 30, 2005			
	Umpqua	Western Sierra	Pro Forma Adjustments	Pro Forma Combined
Net interest income	$51,082	$14,355	$ 1,427(a)	$66,864
Provision for loan losses	1,400	460		1,860
Non-interest income	11,924	3,531		15,455
Non-interest expense	36,421	11,066	732(b)	48,219
Income before income taxes	25,185	6,360	695	32,240
Provision for income taxes	9,179	2,269	278(c)	11,726
Net income	$16,006	$ 4,091	$ 417	$20,514
Earnings per share:				
Basic	$ 0.36			$ 0.36
Diluted	$ 0.36			$ 0.35
Average shares outstanding:				
Basic	44,436	7,713	4,705(d)	56,854
Diluted	44,988	7,982	4,869(d)	57,839

(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.

(in thousands, except per share data)

	Six Months Ended June 30, 2005			
	Umpqua	Western Sierra	Pro Forma Adjustments	Pro Forma Combined
Net interest income	$100,932	$28,200	$3,441(a)	$132,573
Provision for loan losses	2,400	910		3,310
Non-interest income	22,526	6,140		28,666
Non-interest expense	71,856	20,881	1,464(b)	94,201
Income before income taxes	49,202	12,549	1,977	63,728
Provision for income taxes	18,177	4,435	791(c)	23,403
Net income	$ 31,025	$ 8,114	$1,186	$ 40,325
Earnings per share:				
Basic	$ 0.70			$ 0.71
Diluted	$ 0.69			$ 0.70
Average shares outstanding:				
Basic	44,384	7,679	4,684(d)	56,747
Diluted	44,972	7,972	4,863(d)	57,807

(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:

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(in thousands)

	Western Sierra 2006
Beginning balance	$
Additions:	
Severance, retention and other compensation	5,285
Other	22
Utilization:	
Cash payments	(130)
Non-cash write-downs and other adjustments	(72)
Ending Balance	$ 5,105

The Company expects to incur approximately $1.4 million 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 six months ended June 30, 2006 and 2005:

Earnings Per Share

(in thousands, except per share data)

	Three months ended June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 30, 2005
Basic earnings per share:				
Weighted average shares outstanding	48,529	44,436	46,604	44,384
Net income	$ 19,631	$ 16,006	$ 37,058	$ 31,025
Basic earnings per share	$ 0.40	$ 0.36	$ 0.80	$ 0.70
Diluted earnings per share:				
Weighted average shares outstanding	48,529	44,436	46,604	44,384
Net effect of the assumed exercise of stock options and vesting of restricted shares, based on the treasury stock method	465	552	508	588
Total weighted average shares and common stock equivalents outstanding	48,994	44,988	47,112	44,972
Net income	$ 19,631	$ 16,006	$ 37,058	$ 31,025
Diluted earnings per share	$ 0.40	$ 0.36	$ 0.79	$ 0.69

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 principally 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:

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Segment Information

(in thousands)	Three Months Ended June 30, 2006 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$91,704	$ 18	$2,221	$93,943
Interest expense	31,598		1,588	33,186
Net interest income	60,106	18	633	60,757
Provision for loan losses	54			54
Non-interest income	8,668	2,617	2,521	13,806
Non-interest expense	36,916	2,469	2,202	41,587
Merger-related expense	1,656			1,656
Income before income taxes	30,148	166	952	31,266
Provision for income taxes	11,185	60	390	11,635
Net income	$18,963	$ 106	$ 562	$19,631

(in thousands)	Six Months Ended June 30, 2006 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$170,974	$ 40	$3,675	$174,689
Interest expense	56,994		2,659	59,653
Net interest income	113,980	40	1,016	115,036
Provision for loan losses	75			75
Non-interest income	16,618	5,094	4,296	26,008
Non-interest expense	71,086	5,045	4,185	80,316
Merger-related expense	1,907			1,907
Income before income taxes	57,530	89	1,127	58,746
Provision for income taxes	21,166	60	462	21,688
Net income	$ 36,364	$ 29	$ 665	$ 37,058

(in thousands)	Three Months Ended June 30, 2005 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Interest income	$66,213	$ 20	$ 1,430	$67,663
Interest expense	15,721		860	16,581
Net interest income	50,492	20	570	51,082
Provision for loan losses	1,400			1,400

Non-interest income	8,697	2,953	274	11,924
Non-interest expense	31,290	2,860	2,110	36,260
Merger-related expense	161			161
Income before income taxes	26,338	113	(1,266)	25,185
Provision for income taxes	9,649	37	(507)	9,179
Net income	$16,689	$ 76	$ (759)	$16,006

	Six Months Ended June 30, 2005			
(in thousands)	**Community Banking**	**Retail Brokerage**	**Mortgage Banking**	**Consolidated**
Interest income	$129,214	$ 33	$ 2,890	$132,137
Interest expense	29,491		1,714	31,205
Net interest income	99,723	33	1,176	100,932
Provision for loan losses	2,400			2,400
Non-interest income	14,755	6,130	1,641	22,526
Non-interest expense	61,906	5,732	3,956	71,594
Merger-related expense	262			262
Income before income taxes	49,910	431	(1,139)	49,202
Provision for income taxes	18,478	155	(456)	18,177
Net income	$ 31,432	$ 276	$ (683)	$ 31,025

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(in thousands)	June 30, 2006 Community Banking	Retail Brokerage	Mortgage Banking	Consolidated
Total assets	$6,980,419	$7,040	$192,484	$7,179,943
Total loans	$5,133,777	$	$162,943	$5,296,720
Total deposits	$5,464,702	$	$ 68	$5,464,770

(in thousands)	December 31, 2005 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

Note 6 Recently Issued Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (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 Statement of Financial Accounting Standards No. (SFAS) 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 the adoption of SFAS No. 156.

In March 2004, the FASB ratified the consensus reached by the Emerging Issues Task Force regarding Issue 03-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (EITF 03-1 *).* The consensus provided guidance for determining when an investment is other-than-temporarily impaired and established disclosure requirements for investments with unrealized losses. The guidance was effective for periods beginning after June 15, 2004. On September 30, 2004, the FASB deferred the implementation of the recognition criteria of EITF 03-1. In November 2005, the FASB issued FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. This FSP nullifies certain requirements of EITF 03-1. Based on the clarification provided in FSP FAS 115-1 and FAS 124-1, the amount of any other-than-temporary impairment that needs to be recognized will continue to be dependent on market conditions, the occurrence of certain events or changes in circumstances relative to an investee and an entity s intent and ability to hold the impaired investment at the time of the valuation. The Company adopted FSP FAS 115-1 and FAS 124-1 effective January 1, 2006. Adoption of this FSP did not have a material effect on our financial condition or results of operations.

In December 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position (SOP) 03-3, *Accounting for Certain Loans and Debt Securities Acquired in a Transfer*. SOP 03-3 addresses the accounting for acquired loans that show evidence of having deteriorated in terms of credit quality since their origination and for which a loss is deemed probable of occurring. SOP 03-3 requires acquired loans to be recorded at their fair value, defined as the present value of future cash flows including interest income, to be recognized over the life of the loan. SOP 03-3 prohibits the carryover of an allowance for loan loss on certain acquired loans within its scope considered in the future cash flow assessments. SOP 03-3 was effective for loans acquired in fiscal years beginning after December 15, 2004 and has not had a material effect on our financial condition or results of operations.

Note 7 Junior Subordinated Debentures

As of June 30, 2006, the Company had 14 wholly-owned trusts (Trusts) that were formed to issue trust preferred securities and

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related common securities of the Trusts and are not consolidated. Five Trusts, representing aggregate total obligations of approximately $58.9 million (fair value of approximately $68.6 million as of the merger date), were assumed in connection with the Humboldt merger. Four Trusts, representing aggregate total obligations of approximately $37.1 million (fair value of approximately $38.7 million as of the merger date), were assumed in connection with the Western Sierra merger. Following is information about the Trusts:

Junior Subordinated Debentures
(in thousands)

Trust Name	Issue Date	Issued Amount	Carrying Value (1)	Rate (2)	Effective Rate (3)	Maturity Date	Call Date
Umpqua Holdings Statutory Trust I	September 2002	$ 25,774	$ 25,774	Floating (4)	8.96%	September 2032	September 2007
Umpqua Statutory Trust II	October 2002	20,619	20,619	Floating (5)	8.50%	October 2032	October 2007
Umpqua Statutory Trust III	October 2002	30,928	30,928	Floating (6)	8.62%	November 2032	November 2007
Umpqua Statutory Trust IV	December 2003	10,310	10,310	Floating (7)	7.92%	January 2034	January 2009
Umpqua Statutory Trust V	December 2003	10,310	10,310	Floating (7)	8.25%	March 2034	March 2009
HB Capital Trust I	March 2000	5,310	6,636	10.875%	7.73%	March 2030	March 2010
Humboldt Bancorp Statutory Trust I	February 2001	5,155	6,110	10.200%	7.87%	February 2031	February 2011
Humboldt Bancorp Statutory Trust II	December 2001	10,310	11,673	Floating (8)	7.42%	December 2031	December 2006
Humboldt Bancorp Staututory Trust III	September 2003	27,836	31,700	6.75% (9)	4.89%	September 2033	September 2008
CIB Capital Trust	November 2002	10,310	11,460	Floating (6)	7.32%	November 2032	November 2007
Western Sierra Statutory Trust I	July 2001	6,196	6,519	Floating (10)	6.49%	July 2031	July 2006
Western Sierra Statutory Trust II	December 2001	10,300	10,837	Floating (8)	6.73%	December 2031	December 2006
Western Sierra Statutory Trust III	September 2003	10,310	10,673	Floating (11)	6.45%	September 2033	September 2008
Western Sierra Statutory Trust IV	September 2003	10,310	10,673	Floating (11)	6.45%	September 2033	September 2008
	Total	$193,978	$204,222				

(1) Includes purchase accounting adjustments, net of accumulated amortization,

for junior subordinated debentures assumed in connection with the Humboldt and Western Sierra mergers.

(2) Contractual interest rate of junior subordinated debentures.

(3) Effective interest rate as of June 2006, including impact of purchase accounting amortization.

(4) Rate based on LIBOR plus 3.50%, adjusted quarterly.

(5) Rate based on LIBOR plus 3.35%, adjusted quarterly.

(6) Rate based on LIBOR plus 3.45%, adjusted quarterly.

(7) Rate based on LIBOR plus 2.85%, adjusted quarterly.

(8) Rate based on LIBOR plus 3.60%, adjusted quarterly.

(9) Rate fixed for 5 years from

issuance, then adjusted quarterly thereafter based on LIBOR plus 2.95%.

(10) Rate based on LIBOR plus 3.58%, adjusted quarterly.

(11) Rate based on LIBOR plus 2.90%, adjusted quarterly.

The $204.2 million of junior subordinated debentures issued to the Trusts as of June 30, 2006 ($165.7 million as of December 31, 2005) are reflected as junior subordinated debentures in the consolidated balance sheets. The common stock issued by the Trusts is recorded in other assets in the consolidated balance sheets, and totaled $5.8 million at June 30, 2006 as compared to $4.7 million at December 31, 2005.

All of the debentures issued to the Trusts, less the common stock of the Trusts, qualified as Tier 1 capital as of June 30, 2006, under guidance issued by the Board of Governors of the Federal Reserve System (Federal Reserve Board). Effective April 11, 2005, the Federal Reserve Board adopted a rule that permits the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the Federal Reserve Board rule, after a five-year transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other restricted core capital elements is limited to 25% of Tier 1 capital elements, net of goodwill. 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 includes all currently issued trust preferred securities in Tier 1 capital. There can be no assurance that the Federal Reserve Board will not further limit the amount of trust preferred securities permitted to be included in Tier 1 capital for regulatory capital purposes.

Note 8 Commitments and Contingencies

Lease Commitments The Company leases 110 sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times upon expiration.

Rent expense for the three and six months ended June 30, 2006 was $2.0 million and $4.0 million, respectively, compared to $1.5 million and $3.0 million in the comparable periods in 2005. Rent expense was offset by rent income for the three and six months ended June 30, 2006 of $68,000 and $123,000, respectively, compared to $82,000 and $153,000 in the comparable periods in 2005.

Financial Instruments with Off-Balance-Sheet Risk The Company s financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of the Bank s business and involve elements of credit, liquidity and interest rate risk. The following table presents a summary of the Bank s commitments and contingent liabilities as of June 30, 2006:

(in thousands)

	As of June 30, 2006
Commitments to extend credit	$ 1,384,670
Commitments to extend overdrafts	$ 90,413
Commitments to originate loans held-for-sale	$ 61,835
Forward sales commitments	$ 12,983
Standby letters of credit	$ 45,047

The Bank is a party to financial instruments with off-balance-sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit and financial guarantees. Those instruments involve elements of credit and interest-rate risk similar to the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of the Bank s involvement in particular classes of financial instruments.

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, and financial guarantees written, 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 condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. While most standby letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management s credit evaluation of the counterparty. Collateral varies but may include cash, accounts receivable, inventory, premises and equipment and income-producing commercial properties.

The Bank enters into forward delivery contracts to sell residential mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its portfolio of mortgage loans held for sale and its residential mortgage loan commitments. Credit risk associated with forward contracts is limited to the replacement cost of those forward contracts in a gain position. There were no counterparty default losses on forward contracts in the three and six months ended June 30, 2006 and 2005. Market risk with respect to forward contracts arises principally from changes in the value of contractual positions due to changes in interest rates. The Bank limits its exposure to market risk by monitoring differences between commitments to customers and forward contracts with broker/dealers. In the event the Company has forward delivery contract commitments in excess of available mortgage loans, the Company completes the transaction by either paying or receiving a fee to or from the broker/dealer equal to the increase or decrease in the market value of the forward contract. At June 30, 2006, the Bank had commitments to originate mortgage loans totaling $61.8 million with a net fair value liability of approximately $44,000. As of that date, it also had forward sales commitments of $13.0 million with a net fair value asset of $66,000. The Bank recorded gains related to its commitments to originate mortgage loans and related forward sales commitments of $205,000 and $232,000 in the three and six months ended June 30, 2006 as compared to losses of $176,000 and $165,000 in the comparable periods in 2005, respectively.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. The Bank has not been required to perform on any financial guarantees and did not incur any losses in connection with standby letters of credit during the three and six months ended June 30, 2006 and 2005. At June 30, 2006, approximately $14.9 million of standby letters of credit expire within one year, and $30.1 million expire thereafter. Upon issuance, the Company recognizes a liability equivalent to the amount of fees received from the customer for these standby letter of credit commitments. Fees are recognized ratably over the term of the standby letter of credit. The fair value of guarantees associated with standby letters of credit was $176,000 as of June 30, 2006.

At June 30, 2006, the reserve for unfunded commitments, which is included in other liabilities on the consolidated balance sheet, was approximately $2.1 million. The adequacy of the reserve for unfunded commitments is reviewed on a quarterly basis, based upon

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changes in the amounts of commitments, loss experience, and economic conditions.

Mortgage loans sold to investors may be sold with servicing rights retained, with only the standard legal representations and warranties regarding recourse to the Bank. Management believes that any liabilities that may result from such recourse provisions are not significant.

Legal Proceedings In the ordinary course of business, various claims and lawsuits are brought by and against the Company, the Bank and Strand. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the Company s consolidated financial condition or results of operations.

Concentrations of Credit Risk The Company grants real estate mortgage, real estate construction, commercial, agricultural and installment loans and leases to customers throughout Oregon, Washington and California. In management s judgment, a concentration exists in real estate-related loans, which represented approximately 81% and 78% of the Company s loan portfolio at June 30, 2006 and December 31, 2005, respectively. Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations to have no more than the normal risk of collectibility, a substantial decline in the economy in general, or a decline in real estate values in the Company s primary market areas in particular, could have an adverse impact on the collectibility of these loans. Personal and business income represent the primary source of repayment for a majority of these loans.

The Bank recognizes the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to any single correspondent, the Bank has established general standards for selecting correspondent banks as well as internal limits for allowable exposure to any single correspondent. In addition, the Bank has an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations per issuer.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Report contains certain forward-looking statements, which are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. These statements may include statements that expressly or implicitly predict future results, performance or events. In addition, the words expect, believe, anticipate and other similar expressions identify forward-looking statements. All statements other than statements of historical fact are forward-looking statements. Forward-looking statements involve substantial risks and uncertainties, many of which are difficult to predict and are generally beyond the control of Umpqua. Risks and uncertainties include the following:

- The ability to attract new deposits and loans
- Competitive market pricing factors
- Deterioration in economic conditions that could result in increased loan losses
- Market interest rate volatility
- Changes in legal or regulatory requirements
- The ability to recruit and retain certain key management and staff
- Risks associated with merger integration

There are many factors that could cause actual results to differ materially from those contemplated by these forward-looking statements. Specific risks in this report include the ability of the Company to realize significant cost savings as a result of the Western Sierra merger. We do not intend to update these forward-looking statements. Readers should consider any forward-looking statements in light of this explanation, and we caution readers about relying on forward-looking statements.

General

Umpqua Holdings Corporation (referred to in this report as we, our, and the Company), an Oregon corporation, is a financial holding company with two principal operating subsidiaries, Umpqua Bank (the Bank) and Strand, Atkinson, Williams and York, Inc. (Strand).

Our headquarters is located in Portland, Oregon, and we engage primarily in the business of commercial and retail banking and the delivery of retail brokerage services. The Bank provides a wide range of banking, mortgage banking and other financial services to corporate, institutional and individual customers. Along with our subsidiaries, we are subject to the regulations of state and federal agencies and undergo periodic examinations by these regulatory agencies.

We are considered one of the most innovative community banks in the United States, combining a retail product delivery approach with an emphasis on quality-assured personal service. Beginning in 1995, we have transformed the Bank from a traditional community bank into a community-oriented financial services retailer by implementing a variety of retail marketing strategies to increase revenue and differentiate ourselves from our competition.

Strand is a registered broker-dealer and investment advisor with offices in Portland, Eugene, and Medford, Oregon, and offers a full range of investment products and services including: stocks, fixed income securities (municipal, corporate, and government bonds, CDs, money market instruments), mutual funds, annuities, options, retirement planning, money management services, life insurance, disability insurance and medical supplement policies.

Executive Summary and Highlights

Highlights for the second quarter of 2006 were as follows:

- Net income per diluted share was $0.40 for the second quarter of 2006, an increase of 11% over the $0.36 per diluted share earned in the second quarter of 2005.

On June 2, 2006, we completed the acquisition of Western Sierra Bancorp (Western Sierra) and its principal operating subsidiaries, Western Sierra National Bank, Central California Bank, Lake Community Bank and Auburn Community Bank in an all stock exchange valued at $353.7 million with 12.7 million shares of common stock issued in connection with the acquisition.

The Western Sierra acquisition was accretive to operating earnings (which exclude merger expenses, net of tax) by $0.01 per diluted share during the second quarter, based mainly on accelerated synergy realization.

Total consolidated assets as of June 30, 2006 were $7.2 billion, compared to $5.4 billion at December 31, 2005, an increase of $1.8 billion or 34%. The Western Sierra acquisition accounted for $1.5 billion of the growth. Annualized organic growth (which excludes growth from acquisition as of the merger date) was 12% in the six months ended June 30, 2006.

Total gross loans and leases were $5.3 billion as of June 30, 2006, compared to $3.9 billion at December 31, 2005, an increase of $1.4 billion or 35%. The Western Sierra acquisition accounted for $1.0 billion of the growth. Annualized organic growth (which excludes growth from acquisition as of the merger date) was 18% in the six months ended June 30, 2006.

Total deposits were $5.5 billion as of June 30, 2006, compared to $4.3 billion at December 31, 2005, an increase of $1.2 billion or 27%. The Western Sierra acquisition accounted for $1.0 billion of the growth. Annualized organic growth (which excludes growth from acquisition as of the merger date) was 8% in the six months ended June 30, 2006.

Credit quality continued to improve. Non-performing assets were $7.4 million at June 30, 2006 or 0.10% of total assets, a decrease compared to $7.6 million or 0.14% of total assets at December 31, 2005.

With net recoveries of $513,000 in the six months ended June 30, 2006 and credit quality improvement, there was no substantial provision for credit losses during the three and six months ended June 30, 2006. This compared to a provision of $1.4 million and $2.4 million for the same periods a year ago.

Net interest margin decreased to 4.68% and 4.69% for the three and six months ended June 30, 2006, compared to 4.81% and 4.82% for the same periods a year ago, due to increases in short-term market interest rates which led to an increase in deposit and borrowing costs.

Summary of Critical Accounting Policies

Our significant accounting policies are described in Note 1 to the Consolidated Financial Statements for the year ended December 31, 2005 included in the Form 10-K filed with the Securities and Exchange Commission (SEC) on March 14, 2006. Not all of these critical accounting policies require management to make difficult, subjective or complex judgments or estimates. Management believes that the following policies would be considered critical under the SEC s definition.

Allowance for Loan Losses and Reserve for Unfunded Commitments

The Bank performs regular credit reviews of the loan portfolio to determine the credit quality of the portfolio and the adherence to underwriting standards. When loans are originated, they are assigned a risk rating that is assessed periodically during the term of the loan through the credit review process. The risk ratings are a primary factor in determining an appropriate amount for the allowance for loan losses. Management s Allowance for Loan Losses (ALL) Committee is responsible for regular review of the ALL methodology, including loss factors, and ensuring that it is designed and applied in accordance with generally accepted accounting principles. The ALL Committee reviews loans that have been placed on non-accrual status and approves placing loans on impaired status. The ALL Committee also approves removing loans that are impaired from impairment and non-accrual status.

Each risk rating is assessed an inherent credit loss factor that determines the amount of the allowance for loan losses provided for that group of loans with similar risk rating. Credit loss factors may vary by region based on management s belief that there may ultimately be different credit loss rates experienced in each region.

Regular credit reviews of the portfolio also identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALL Committee which reviews and approves designating loans as impaired. A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In this case, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the recorded investment in the loan, we recognize this impairment reserve as a specific component to be provided for in the allowance for loan losses. The combination of the risk rating-based allowance component and the impairment reserve allowance component lead to an allocated allowance for loan losses. The Bank also maintains an unallocated allowance amount to provide for other credit losses inherent in the loan portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance. The unallocated amount is reviewed periodically based on trends in credit losses, the results of credit reviews and overall economic trends.

The reserve for unfunded commitments (RUC) is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALL and RUC are monitored on a regular basis and are based on management s evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio s risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all significant problem loans; historical charge-off and recovery experience; and other pertinent information.

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Mortgage Servicing Rights

Retained mortgage servicing rights are measured by allocating the carrying value of the loans between the assets sold and the interest retained, based on their relative fair values at the date of the sale. Subsequent measurements are determined using a discounted cash flow model. Mortgage servicing rights are amortized over the expected life of the loan and are evaluated periodically for impairment. The expected life of the loan can vary from management s estimates due to prepayments by borrowers, especially when interest rates fall. Prepayments in excess of management s estimates would negatively impact the recorded value of the mortgage servicing rights. The value of the mortgage servicing rights is also dependent upon the discount rate used in the model. Management reviews this rate on an ongoing basis based on current market rates. A significant increase in the discount rate would reduce the value of mortgage servicing rights.

Valuation of Goodwill and Intangible Assets

At June 30, 2006, we had $682.8 million in goodwill and other intangible assets as a result of business combinations. Goodwill and other intangibles with indefinite lives are not amortized but instead are periodically tested for impairment. Management performs an impairment analysis for the intangible assets with indefinite lives on a quarterly basis and determined that there was no impairment as of June 30, 2006. The valuation is based on discounted cash flows or observable market prices on a segment basis. A 10% or 20% decrease in market price is not expected to result in an impairment. If impairment was deemed to exist, a write down of the asset would occur with a charge to earnings.

Stock-based Compensation

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share Based Payment*, a revision to the previously issued guidance on accounting for stock options and other forms of equity-based compensation. Additional information is included in Note 2 of the *Notes to Condensed Consolidated Financial Statements*.

RESULTS OF OPERATIONS

OVERVIEW

For the three months ended June 30, 2006, net income was $19.6 million, or $0.40 per diluted share, an increase of 11% on a per diluted share basis as compared to $16.0 million, or $0.36 per diluted share for the three months ended June 30, 2005. For the six months ended June 30, 2006, net income was $37.1 million, or $0.79 per diluted share, an increase of 14% on a per diluted share basis as compared to $31.0 million, or $0.69 per diluted share for the six months ended June 30, 2005. The improvement in diluted earnings per share for the six months ended June 30, 2006 is principally attributable to improved net interest income, partially offset by increased operating expenses.

We incur significant expenses related to the completion and integration of mergers. Accordingly, we believe that our operating results are best measured on a comparative basis excluding the impact of merger-related expenses, net of tax. We define *operating income* as income before merger related expenses, net of tax, and we calculate *operating income per diluted share* by dividing operating earnings by the same diluted share total used in determining diluted earnings per share (see Note 4 of the *Notes to Condensed Consolidated Financial Statements*). Operating income and operating income per diluted share are considered non-GAAP financial measures. Although we believe the presentation of non-GAAP financial measures provides a better indication of our operating performance, readers of this report are urged to review the GAAP results as presented in the *Condensed Consolidated Financial Statements*.

The following table presents a reconciliation of operating income and operating income per share to net income and net income per share for the three and six months ended June 30, 2006 and 2005:

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Reconciliation of Operating Income to Net Income
(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2006	**2005**	**2006**	**2005**
Net income	$ 19,631	$ 16,006	$ 37,058	$ 31,025
Merger-related expenses, net of tax	994	97	1,144	157
Operating income	$ 20,625	$ 16,103	$ 38,202	$ 31,182
Per diluted share:				
Net income	$ 0.40	$ 0.36	$ 0.79	$ 0.69
Merger-related expenses, net of tax	0.02		0.02	
Operating income	$ 0.42	$ 0.36	$ 0.81	$ 0.69

The following table presents the returns on average assets, average shareholders equity and average tangible shareholders equity for the three and six months ended June 30, 2006 and 2005. For each of the periods presented, the table includes the calculated ratios based on reported net income and operating income as shown in the Table above. Our return on average shareholders equity is negatively impacted as the result of capital required to support goodwill. To the extent this performance metric is used to compare our performance with other financial institutions that do not have merger-related intangible assets, we believe it beneficial to also consider the return on average tangible shareholders equity. The return on average tangible shareholders equity is calculated by dividing net income by average shareholders equity less average intangible assets. The return on average tangible shareholders equity is considered a non-GAAP financial measure and should be viewed in conjunction with the return on average shareholders equity.

Returns on Average Assets, Shareholders Equity and Tangible Shareholders Equity
(dollars in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2006	**2005**	**2006**	**2005**
Returns on average assets:				
Net income	1.31%	1.29%	1.31%	1.27%
Operating income	1.37%	1.30%	1.35%	1.27%
Returns on average shareholders equity:				
Net income	9.18%	9.11%	9.32%	8.95%
Operating income	9.64%	9.17%	9.61%	9.00%
Returns on average tangible shareholders equity:				
Net income	21.17%	21.61%	21.10%	21.48%
Operating income	22.24%	21.74%	21.76%	21.59%
Calculation of average tangible shareholders equity:				

Average shareholders equity	$ 858,168	$ 704,466	$ 801,494	$ 699,039
Less: average intangible assets	(486,167)	(407,364)	(447,405)	(407,760)
Average tangible shareholders equity	$ 372,001	$ 297,102	$ 354,089	$ 291,279

NET INTEREST INCOME

Net interest income is the largest source of our operating income. Net interest income for the three months ended June 30, 2006 was $60.8 million, an increase of $9.7 million, or 19% over the same period in 2005. Net interest income for the six months ended June 30, 2006 was $115.0 million, an increase of $14.1 million, or 14% over the same period in 2005. This increase is attributable to growth in outstanding average interest-earning assets, primarily loans, offset by growth in interest-bearing liabilities, primarily money-market and time deposits, over the same period in 2005.

The net interest margin (net interest income as a percentage of average interest-earning assets) on a fully tax-equivalent basis was 4.68% for the three months ended June 30, 2006, a decrease of 13 basis points as compared to the same period in 2005. The net interest margin on a fully tax-equivalent basis for the six months ended June 30, 2006 was 4.69%, a decrease of 13 basis points as compared to the same period in 2005. This decrease is primarily due to increases in short-term market rates which led to an increase in deposit and borrowing costs. The increased yield on interest-earning assets of 86 and 80 basis points in the three and six months ended June 30, 2006 was more than offset by a corresponding increase in our cost of interest-bearing liabilities which increased by 124

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and 120 basis points in the three and six months ended June 30, 2006.

Our net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, changes in volume, as well as changes in the yields earned on interest-earning assets and rates paid on deposits and borrowed funds, or rates. The following table presents condensed average balance sheet information, together with interest income and yields on average interest-earning assets, and interest expense and rates paid on average interest-bearing liabilities for the three and six months ended June 30, 2006 and 2005:

Average Rates and Balances (Quarterly)

(dollars in thousands)

	Three months ended June 30, 2006			Three months ended June 30, 2005		
	Average Balance	Interest Income or Expense	Average Yields or Rates	Average Balance	Interest Income or Expense	Average Yields or Rates
INTEREST-EARNING ASSETS:						
Loans and leases (1)	$ 4,519,866	$ 86,004	7.63%	$ 3,570,800	$ 60,220	6.76%
Taxable securities	595,993	6,749	4.53%	588,806	6,290	4.27%
Non-taxable securities (2)	88,360	1,228	5.56%	64,575	1,062	6.59%
Temporary investments (3)	32,541	336	4.13%	62,792	434	2.76%
Total interest earning assets	5,236,760	94,317	7.22%	4,286,973	68,006	6.36%
Allowance for credit losses	(49,251)			(46,372)		
Other assets	843,243			739,766		
Total assets	$ 6,030,752			$ 4,980,367		
INTEREST-BEARING LIABILITIES:						
Interest-bearing checking and savings accounts	$ 2,280,089	$ 13,711	2.41%	$ 2,027,536	$ 6,582	1.30%
Time deposits	1,267,003	12,242	3.88%	980,870	6,903	2.82%
Federal funds purchased and repurchase agreements	176,868	1,802	4.09%	72,142	407	2.26%
Term debt	163,400	2,055	5.04%	27,061	139	2.06%
Notes payable on junior subordinated debentures and trust preferred securities	177,510	3,376	7.63%	166,032	2,550	6.16%
Total interest-bearing liabilities	4,064,870	33,186	3.27%	3,273,641	16,581	2.03%
Non-interest-bearing deposits	1,048,201			949,610		
Other liabilities	59,513			52,650		
Total liabilities	5,172,584			4,275,901		

Shareholders equity	858,168		704,466	
Total liabilities and shareholders equity	$ 6,030,752		$ 4,980,367	
NET INTEREST INCOME (2)		$ 61,131		$ 51,425
NET INTEREST SPREAD		3.95%		4.33%
AVERAGE YIELD ON EARNING ASSETS (1) (2)		7.22%		6.36%
INTEREST EXPENSE TO EARNING ASSETS		2.54%		1.55%
NET INTEREST INCOME TO EARNING ASSETS (1) (2)		4.68%		4.81%

(1) Non-accrual loans and mortgage loans held for sale are included in the average balance.

(2) Tax-exempt income has been adjusted to a tax equivalent basis at a 35% tax rate. The amount of such adjustment was an addition to recorded income of approximately $374,000 and $343,000 for the three months ended June 30, 2006 and 2005, respectively.

(3)

Temporary investments include federal funds sold and interest-bearing deposits at other banks.

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Average Rates and Balances (Year-to-Date)
(dollars in thousands)

	Six months ended June 30, 2006			Six months ended June 30, 2005		
	Average Balance	Interest Income or Expense	Average Yields or Rates	Average Balance	Interest Income or Expense	Average Yields or Rates
INTEREST-EARNING ASSETS:						
Loans and leases (1)	&nb					