

**Peoples Bancorporation**

PROPERTY OF  
SEATTLE PUBLIC LIBRARY

**Annual Report 1985**





*In Memoriam*

# *Joshua Green Jr.*



*(December 9, 1908–October 18, 1985)*

*We at Peoples Bancorporation  
were saddened this past October by the death of  
Joshua Green, Jr.*

*In business, Mr. Green followed  
his own beliefs: fairness in competition, quality in  
service and the highest ethical  
standards in all customer affairs.*

*In his personal life,  
his creed was equally strong: love for  
his family, dedication to his community and  
loyalty to his friends.*



Peoples Bancorporation and Subsidiaries  
**Consolidated Financial Highlights**

(In Thousands, Except Per Share)

	1985	1984	% Change
<b>For the Year</b>			
Net income	\$14,267	\$15,077	(5)%
Cash dividends declared	3,776	3,772	—
<b>Per Share</b>			
Net income	\$ 3.78	\$ 4.00	(5)%
Cash dividends declared	1.00	1.00	—
Book value	36.96	34.19	8
<b>At Year-End</b>			
Assets	\$2,380,341	\$2,173,333	10 %
Loans and leases	1,566,543	1,395,484	12
Deposits	1,993,990	1,786,551	12
Shareholders' equity	139,750	128,889	8

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# Management's *primary objective* for Peoples Bancorporation is clear—to provide quality financial services to the residents and businesses of the Pacific Northwest.

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Over the past three years, we have made significant progress toward fulfilling this goal. We are pleased with our success in becoming a major corporate banking competitor. We seized a unique opportunity in the early 1980s to move into this position when the state's largest bank experienced difficulties. While recognizing that rapid growth in our portfolio could result in some loans which would ultimately not meet our standards, we aggressively pursued Washington's middle-market corporations. We did experience substantial growth in business loans and now are facing the anticipated problem loans that always follow a growth cycle.

Partially as a result of heavy loan charge-offs, 1985 net income of \$14.3 million represents a decline of 5.4% from 1984 income of \$15.1 million. Earnings per share were \$3.78 compared to \$4.00 in 1984. Another factor affecting this decline is a modest 8.7% increase in non-interest income.

Although our 1985 non-performing assets and net charge-offs are acceptable by industry norms, they are not acceptable to our management. Non-performing assets increased from 1.0% of total assets in 1984 to 1.6% in 1985. Net loan losses increased from \$4.6 million to \$7.9 million.

In 1986, we will focus on reducing our non-performing assets, loan losses and operating costs. We anticipate that profits will be weak during the first half of 1986 as we concentrate on resolving our problem loans. However, we expect to enter 1987 with an improved loan portfolio and a substantially higher level of operating income.

On the consumer side of our business, we continued to identify and target segments of the market in order

to focus on products and delivery systems appropriate to our customer base. We are recruiting additional highly qualified people with expertise in various specialized aspects of banking. As deregulation changes the financial services industry, we are dedicated to playing a successful, competitive role. We will concentrate on achieving a critical balance between the profitability of the bank and the increasing demands of the marketplace as we develop new products and redesign existing ones.

Our goal of providing convenient electronic services to our customers in a cost effective manner was greatly enhanced in 1985 when the Northwest Electronic Network (NEN)—owned by PeoplesBank and four other major Washington banks—signed a definitive agreement to merge with The Exchange. As a result of the merger, PeoplesBank customers will be able to access a substantially greater number of cash machines. Development of point-of-sale systems like the one being tested by PeoplesBank and Rainier Bank is also a priority for NEN. We anticipate that additional market opportunities will open to us as a result of our electronic banking activities and the added convenience they offer to our customers.

In January 1986, James G. Cairns, Jr., formerly president of Peoples Bancorporation, resigned to assume the position of chairman and chief executive officer of First Oklahoma Bancorporation. We are proud of the role he played during his last year with Peoples as head of the American Bankers Association. His presence will be missed at the Washington State Convention and Trade Center, where he served as chairman of the board of directors.

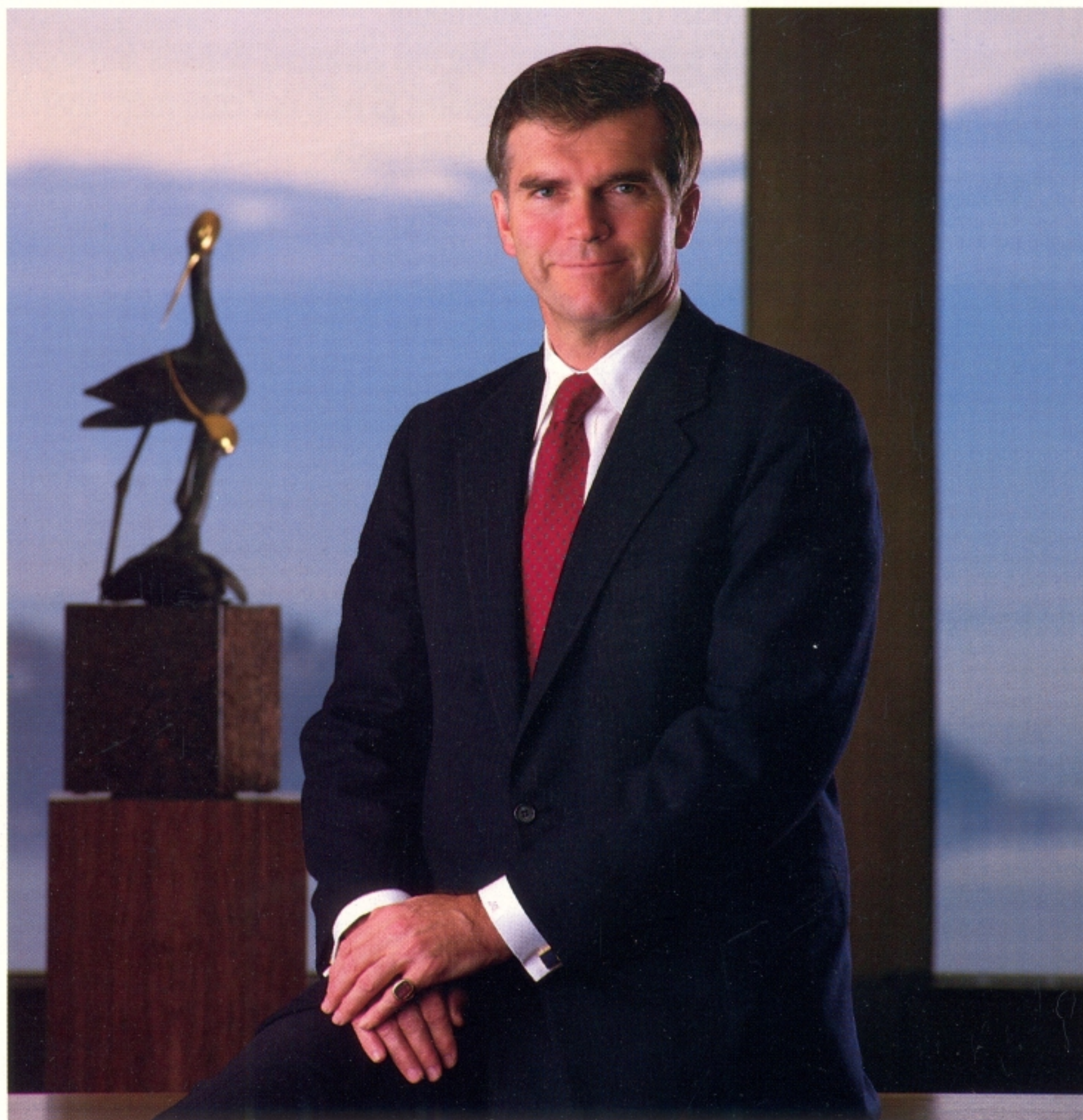


In other senior management changes, Elmer M. Anderson was promoted to vice chairman. Elmer assumed increased responsibilities as a senior representative of the bank to major customers and prospects as well as to civic and community organizations. Thomas G. Andrew, Jr., formerly senior vice president of Wells Fargo Bank in California, joined PeoplesBank this year as senior vice president and manager of Consumer and Community Banking.

We were saddened by the death in 1985 of Peoples Bancorporation Honorary Chairman Joshua Green, Jr.

My father served the bank as chief executive officer from 1949 to 1977 and retired as chairman of the board in 1979. During his 30 years of leadership, PeoplesBank emerged as a major financial institution in the Pacific Northwest. His contributions to the bank and the Washington state business community will be long remembered.

We are proud of our tradition of consistent management and solid earnings. In the year ahead, we will dedicate our efforts to achieving our historical earnings level.



*Joshua Green III*

Joshua Green III  
Chairman of the Board and Chief Executive Officer



# Our people *make the difference. Their enthusiasm, competence and professional attitude toward customers distinguish PeoplesBank from our competition.*

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The financial services industry is undergoing rapid change as deregulation creates a more competitive environment. In order to be successful, companies which offer financial services must understand what products their customers need and how to deliver these products. In 1986, Peoples will continue to focus on serving our customers and strengthening our sales and service.

**Sales**—At Peoples Bancorporation, we gather a variety of economic, demographic and competitive data about markets we serve in Washington state. Results from this analysis enable our sales personnel to better understand the communities in which we operate. This market data, our dedicated staff and the knowledge we have gained from nearly 100 years of living with and serving the people and businesses of Washington state place Peoples in a strong competitive position.

In the corporate banking area, our assignment of an account relationship manager to each corporate account continues to be successful. Emphasis in 1986 will be on additional cross-selling of services as well as on

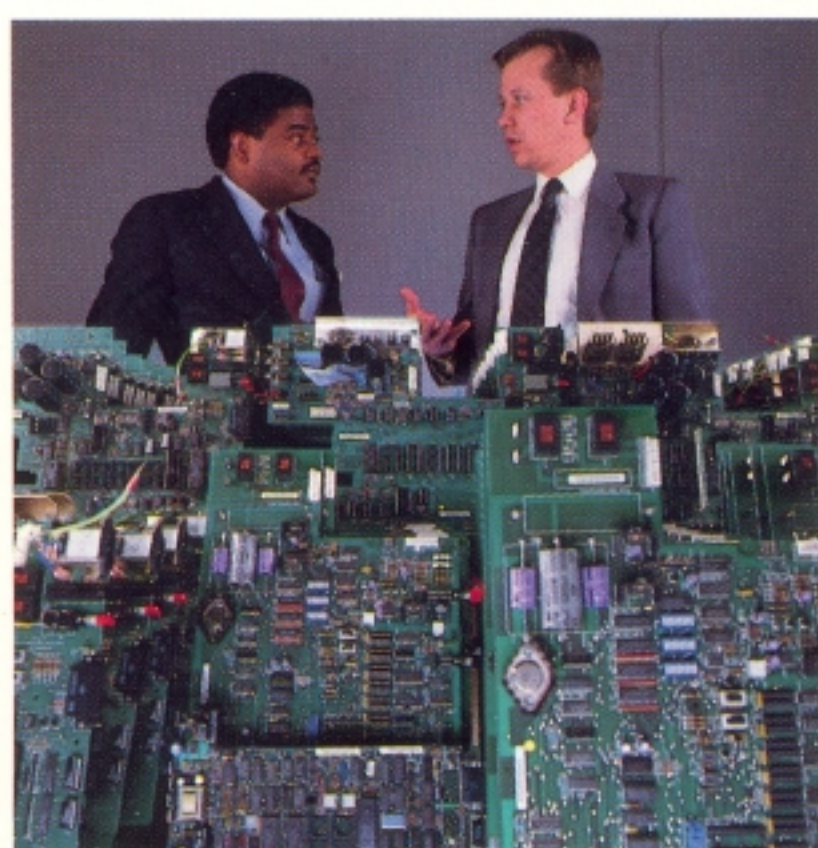
developing new corporate relationships.

**Service**—The quality of service given to our customers determines the success of the relationship. At Peoples, our staff pride themselves in doing things correctly the first time. Customer satisfaction is paramount.

We use advanced systems and sophisticated programs to help our customers analyze and plan their financial needs.

**Support**—Whether or not they are in daily contact with the customer, Peoples employees insure that customer needs are handled in an accurate and timely fashion. In addition, our support employees are responsible for the recruiting and training of our staff and for developing the innovative and useful products that are vital to the success of the company.

Because of the dedicated efforts of our entire sales, service and support team, Peoples Bancorporation offers financial services which represent a unique value in our marketplace.



Account Relationship Manager Eli Mackey, Jr. (left) confers with Intermec Corporation's Chief Financial Officer Charles A. Anderson about the company's latest manufacturing techniques. PeoplesBank provides an industrial revenue bond, investments, cash management services, commercial loans and international services to this \$40 million Lynnwood manufacturer of bar code data collection systems.



Referring to his on-line teller screen, Skyway Park Banking Office Manager Gary Caskey answers a customer telephone inquiry. In addition to providing complete information about all accounts the customer has with Peoples, the system displays the customer's signature, enabling bank personnel to quickly and efficiently serve the customer from any PeoplesBank branch.



Twenty-four hours a day, seven days a week, Peoples Service Center employees like Computer Operator Christy Coe work behind-the-scenes to process deposits and withdrawals, maintain holding company records and program the complex systems which provide information needed by our customers, subsidiaries and correspondent banks.



# Financial Review *of Peoples Bancorporation*

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Consolidated net income for 1985 was \$14.3 million. This represents a decrease of \$.8 million or 5.4% from earnings of \$15.1 million in 1984. Net income per share was \$3.78 compared to \$4.00 in the previous year.

During 1985, we were able to match the exceptionally strong level of commercial loan growth experienced in 1984, again recording an increase in average balances of nearly 30%. Increases in total average loans and deposits exceeded 1984 levels, at 20.0% and 8.5%, respectively.

Net interest income growth of \$5.3 million or 6.1%, however, was considerably below the 18.4% increase reported in 1984, as declines in interest rates reduced our net interest margin. The net interest margin decreased 19 basis points in 1985, contrasting a 72 basis point increase in 1984.

Non-interest income growth of \$3.9 million or 8.7% was also below the 18.9% increase reported in 1984.

Both net credit losses and non-performing assets increased in 1985. Net credit losses increased \$3.3 million, from .37% of average loans and leases in 1984 to .53% in 1985. The \$11.7 million provision charged to expense also included a \$3.7 million addition to the allowance for credit losses, bringing the allowance to

1.20% of outstanding loans and leases at year-end 1985. Non-performing assets were 1.6% of total assets at year-end compared to 1.0% at December 31, 1984.

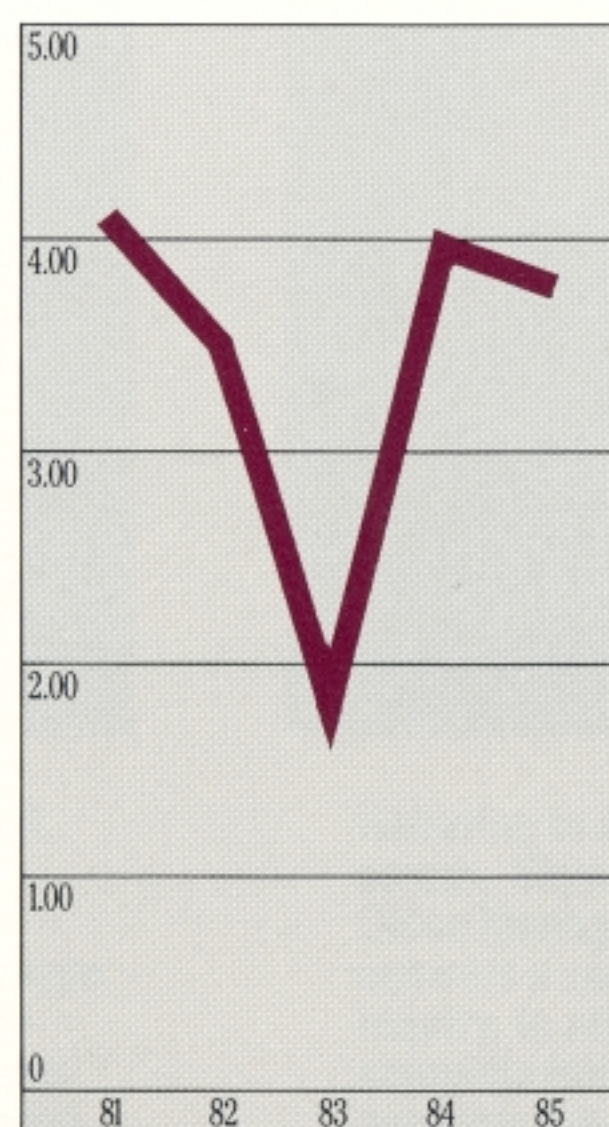
Control of non-interest expenses continues to be a challenge. Non-interest expenses increased \$7.9 million or 7.4% in 1985, following an increase of only \$3.2 million or 3.1% in 1984. Controlling overhead costs and reducing problem credits will be major priorities in 1986.

The key ratios presented on the following page illustrate Peoples Bancorporation's financial performance over the past five years. The returns on average assets and equity were .65% and 10.57%, respectively, in 1985, compared to .73% and 12.30%, respectively, in 1984. These ratios decreased considerably in comparison to 1981, reflecting the effects of deregulation on our cost of funds and the subsequent narrowing of our net interest margin. The loan to deposit ratio declined in 1982 and 1983 as the recession sharply reduced loan demand. However, a strong resurgence in loan growth increased our loan to deposit ratio to 73.72% in 1984 and 81.56% in 1985. Our capital position also strengthened during the last two years. The average equity to asset ratio was 6.14% in 1985, compared to 5.94% in 1984 and 5.67% in 1983.



## Selected Financial Data

Selected Financial Data						Change 85/84	
(In Thousands, Except Per Share)	1985	1984	1983	1982	1981	\$	%
<b>Earnings Summary</b>							
Net interest income	\$ 93,463	\$ 88,117	\$ 74,429	\$80,177	\$75,833	\$5,346	6.1%
Provision for possible credit losses	11,650	8,901	6,099	5,684	3,880	2,749	30.9
Non-interest income	48,398	44,518	37,452	33,986	28,840	3,880	8.7
Non-interest expense	113,500	105,642	102,477	92,465	78,423	7,858	7.4
Net income	14,267	15,077	6,032	13,423	15,613	(810)	(5.4)
<b>Per Share</b>							
Net income:							
Primary	\$ 3.78	\$ 4.00	\$ 1.59	\$ 3.51	\$ 4.09	\$ (.22)	(5.5)%
Fully diluted	3.76	3.81	1.56	3.33	3.83	(.05)	(1.3)
Cash dividends declared	1.00	1.00	1.00	1.00	1.00	—	—
Book value	36.96	34.19	31.17	30.44	27.88	2.77	8.1
<b>Balance Sheet Averages</b>							
Total assets	\$2,198,374	\$2,063,096	\$2,046,031	\$1,841,848	\$1,580,516	\$135,278	6.6%
Loans and leases	1,494,565	1,245,157	1,066,155	979,971	892,132	249,408	20.0
Deposits	1,832,538	1,689,086	1,626,013	1,372,593	1,201,687	143,452	8.5
Long-term debt	9,234	20,650	21,502	18,906	16,402	(11,416)	(55.3)
Shareholders' equity	134,986	122,606	116,049	112,286	97,045	12,380	10.1
<b>Key Ratios</b>							
Return on average assets	.65%	.73%	.29%	.73%	.99%		
Return on average equity	10.57	12.30	5.20	11.95	16.09		
Average equity to average assets	6.14	5.94	5.67	6.10	6.14		
Average loans and leases to average deposits	81.56	73.72	65.57	71.40	74.24		
Cash dividends declared divided by primary net income per share	26.46	25.00	62.89	28.49	24.45		



**Primary Net Income Per Share**  
(Dollars)



**Net Interest Margin**  
(Percent)



## Net Interest Income

Net interest income increased \$5.3 million or 6.1% in 1985. On a fully taxable equivalent basis, the increase was \$5.6 million or 5.8% compared to an increase of \$13.9 million or 17.1% in 1984.

Changes in net interest income are a function of changes in three variables: volume, mix and rate. Although average earning asset growth was higher in 1985 than in 1984, declining interest rates reduced the net interest margin in 1985 while a rising rate environment increased the margin in 1984. Changes in the mix of earning assets continued to benefit the margin in 1985, somewhat reducing the impact of lower rates.

The average volume of earning assets increased 9.4% in 1985, adding \$25.8 million to interest income. Growth in interest bearing liabilities added \$12.2 million to interest expense, resulting in a \$13.6 million increase in net interest income.

Interest rates began to decline in the fourth quarter of 1984 and continued to decline through the third quarter of 1985. Consequently, the yield on our loan portfolio decreased from an average of 12.72% in 1984 to an average of 11.53% in 1985, reducing interest income by \$19.5 million. The total impact of changes in rates earned on assets was a decrease in interest income of \$25.9 million.

Changes in rates had less of an impact on the liability side of our balance sheet, reducing interest expense by \$17.8 million. The resulting effect of changes in rates was an \$8.1 million decrease in net interest income and a 19 basis point decrease in the net interest margin, from 5.65% in 1984 to 5.46% in 1985. The difference between the interest rate sensitivity of our assets and the interest rate sensitivity of our liabilities is primarily caused by our sizable base of non-interest bearing deposits and non-rate sensitive savings accounts. (See page 11 for a further discussion of interest rate sensitivity.)

## Non-Interest Income

Non-interest income increased \$3.9 million or 8.7% in 1985, following an increase of 18.9% in 1984 and 10.2% in 1983.

Commissions and fees from trust services increased \$.6 million or 10.5%, following growth of 16.5% in 1984.

Service charges on deposit accounts, which comprised 27.3% of total non-interest income, were up only \$.2 million or 1.5% in 1985. This reflects a decrease in average non-interest bearing demand deposits, which are the primary source of deposit service charge income. Service charges on deposit accounts increased 10.8% in 1984, as a result of rate increases.

Continuing the trend of the previous year, service charges on computer services declined as other types of fee income increased, including service charges on credit cards, fees from investment services and income from check sales.

Security gains totaled \$.6 million in 1985, reflecting gains recorded in the first quarter of the year on the sale of U.S. Government securities.

Trading account profits increased \$.2 million or 10.7%, following an increase of \$.7 million or 92.3% last year.

In both 1985 and 1984, non-interest income included substantial gains from the sale of bank premises and equipment, and the sale of mortgage loan servicing. In 1985, we recorded a \$1.4 million gain from the sale of our Dexter and Broad branch, while 1984 results included \$1.1 million of profits from the sale of our former computer center and \$.4 million from the sale of other buildings and equipment. Income from the sale of loan servicing by Peoples Mortgage Company totaled \$2.6 million in 1985 and \$1.8 million in 1984. (It should be noted that the reduction in the mortgage servicing portfolio led to a \$.4 million decrease in loan servicing fees in 1985.) In both years, the positive impact of these gains on earnings was offset by increases in credit losses and write-downs of other real estate owned.

In 1985, our mortgage subsidiary also reported an increase in premiums earned on loan sales, which, combined with the bank's gains on sales of foreclosed properties, accounted for \$1.4 million of the increase in other non-interest income. The remainder of the \$2.7 million growth in this category can be attributed to the increase in fees earned on investment services and increased income from check sales.

## Non-Interest Income

Year Ended December 31 (In Thousands)	1985	1984	1983	Change 85/84	
				\$	%
Trust fees and commissions	\$ 6,058	\$ 5,483	\$ 4,705	\$ 575	10.5%
Service charges on deposit accounts	13,232	13,041	11,765	191	1.5
Loan servicing fees	5,154	5,592	5,404	(438)	(7.8)
Service charges on credit card services	4,928	4,323	3,770	605	14.0
Service charges on computer services	2,990	4,255	5,292	(1,265)	(29.7)
Gains on sale of loan servicing	2,649	1,773	—	876	49.4
Gains on sale of bank premises and equipment	1,364	1,472	80	(108)	(7.3)
Securities gains (losses)	629	10	(102)	619	6,190.0
Trading account profits	1,723	1,556	809	167	10.7
Other	9,671	7,013	5,729	2,658	37.9
<b>Total</b>	<b>\$48,398</b>	<b>\$44,518</b>	<b>\$37,452</b>	<b>\$ 3,880</b>	<b>8.7%</b>



## Non-Interest Expense

Year Ended December 31 (In Thousands)	1985	1984	1983	Change 85/84	
				\$	%
Salaries	\$ 49,075	\$ 43,989	\$ 43,388	\$ 5,086	11.6%
Employee benefits	10,272	9,984	9,325	288	2.9
Occupancy	7,349	6,439	5,636	910	14.1
Furniture and equipment	10,609	11,609	11,317	(1,000)	(8.6)
Professional and other fees	7,463	6,489	6,160	974	15.0
Stationery and supplies	3,004	2,524	2,710	480	19.0
State and local taxes	4,331	3,961	3,889	370	9.3
Other real estate owned	3,215	2,812	758	403	14.3
Marketing	2,500	2,173	2,278	327	15.0
Telecommunications	2,395	2,744	2,495	(349)	(12.7)
Litigation settlement	—	—	2,400	—	—
Other	13,287	12,918	12,121	369	2.9
<b>Total</b>	<b>\$113,500</b>	<b>\$105,642</b>	<b>\$102,477</b>	<b>\$ 7,858</b>	<b>7.4%</b>

## Non-Interest Expense

Non-interest expenses increased \$7.9 million or 7.4% in 1985. In comparison, non-interest expense growth was held to a very modest 3.1% in 1984, following a 10.8% increase in 1983. In 1985, the most significant area of change was salary expense, which rose \$5.1 million or 11.6%. This increase was due to a combination of factors, including merit increases, a higher staffing level and compensation expense recorded for the increase in value of stock appreciation rights granted in the Executive Incentive Plan. In comparison, salary expense increased only 1.4% in 1984, partially reflecting the operating efficiencies achieved through the reorganization of our lending functions in 1983.

Occupancy expense was up \$.9 million or 14.1% in 1985, following a similar rise in 1984. In both years, we experienced increases in utility, maintenance and repair costs.

During the three-year period of 1981 to 1983, we experienced substantial increases in furniture and equipment expense due to investments in new equipment and technology. In 1984, we were able to hold the increase in this category to 2.6%, and in 1985, furniture and equipment costs decreased \$1.0 million or 8.6%.

Other non-interest expenses were \$2.6 million or 7.7% above 1984, with increases in all major areas except telecommunications expense, which decreased 12.7%. The generally higher level of expenses can be attributed to the increased volume of business.

As deregulation has raised our cost of funds and narrowed our net interest margin, we have realized that reducing our overhead burden is a necessary step in increasing our long-term profitability. In 1986, we will continue to address this challenge, and we anticipate a lower level of non-interest expense growth than in 1985.

## Income Taxes

Income tax expense was \$2.4 million in 1985 compared to \$3.0 million in 1984. This decrease was primarily the result of the \$1.4 million decline in pretax earnings. Additionally, the effective income tax rate decreased from 16.7% to 14.6%, because of an increase in the proportion of tax-exempt income and investment tax credits to total pretax income. Tax-exempt income represented 22.9% of pretax income in 1984 compared to 24.8% in 1985, while investment tax credits increased from 6.0% to 6.5% of pretax income. See Note 10 for a further discussion of income taxes.

## Loan and Lease Portfolio by Purpose

December 31 (In Thousands)	1985	1984	1983	1982	1981
Commercial, financial and agricultural	\$ 948,617	\$ 785,488	\$ 547,436	\$ 507,868	\$402,962
Real estate construction	29,977	32,892	32,815	21,332	28,061
Real estate mortgage	219,263	251,523	238,783	270,378	244,431
Consumer	339,344	296,775	240,921	239,728	223,779
Lease financing	36,283	37,095	30,656	34,704	46,447
Less unearned income	(6,941)	(8,289)	(7,979)	(9,820)	(12,309)
<b>Total</b>	<b>\$1,566,543</b>	<b>\$1,395,484</b>	<b>\$1,082,632</b>	<b>\$1,064,190</b>	<b>\$933,371</b>



## Sources and Uses of Funds

The following discussion of sources and uses of funds is based on year-to-date average balances (unless otherwise indicated) which are generally more meaningful for comparative purposes than December 31 balances.

### Use of Funds

Our asset management philosophy for 1985 was basically the same as in 1984—to reduce investment balances, which grew considerably during the recessionary period of 1982 and 1983, and to use these funds to increase loan volumes, particularly in the commercial sector.

Total average loans and leases increased \$249.4 million or 20.0% in 1985, exceeding the 16.8% increase reported in 1984. Investment securities decreased \$102.2 million or 34.8%, resulting in a net increase in total earning assets of \$159.1 million or 9.4%. This compares to total earning asset growth of 2.1% in 1984.

As of December 31, 1985, loans and leases were \$1.567 billion compared to \$1.395 billion a year ago. Investment securities were \$181.9 million, down from \$292.9 million a year ago.

The change in our earning asset mix is evident from our ratio of loans and leases to earning assets, which increased from 74% in 1984 to 81% in 1985.

Loan mix also changed, as we shifted the emphasis of our business towards commercial banking. Average commercial loans increased \$200.3 million or 29.6%, following a similar increase in 1984. Commercial loans accounted for 58.6% of the loan and lease portfolio in 1985, compared to 54.3% last year and 41.8% four years ago.

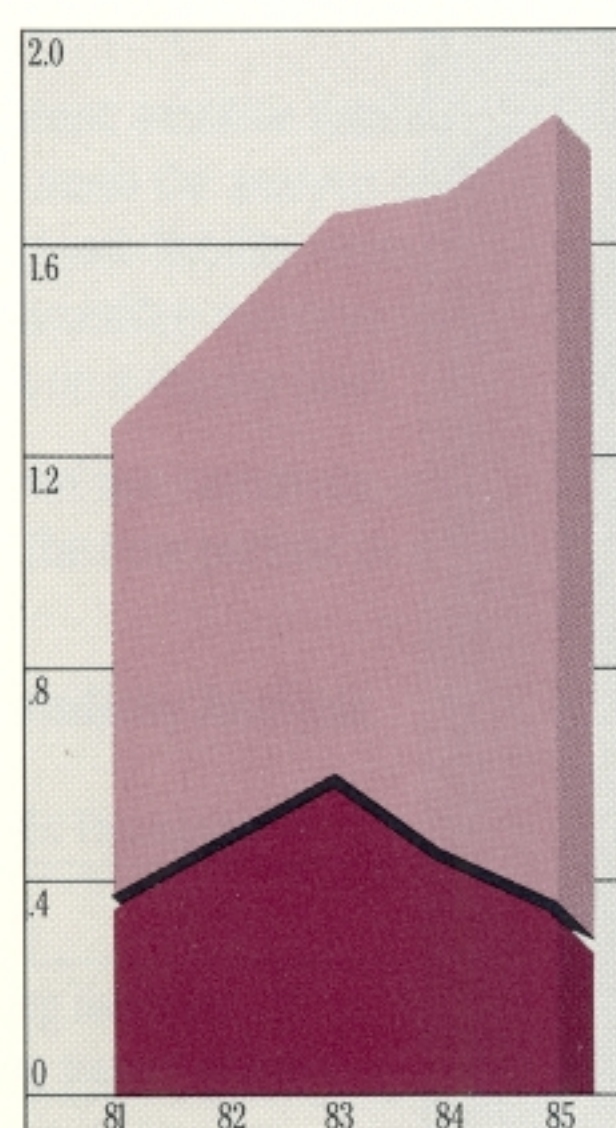
Although we have focused our major efforts on expanding our commercial business, we are committed to maintaining our position in the consumer banking market. Following a 14.6% increase in 1984, average consumer loans were up \$51.4 million or 19.4% in 1985. Consumer loans represented 21.2% of the average loan and lease portfolio in 1985 compared to 21.3% in 1984.

Real estate loan volumes declined \$5.3 million or 1.9% in 1985, while equipment lease financing increased \$3.0 million or 11.3%.

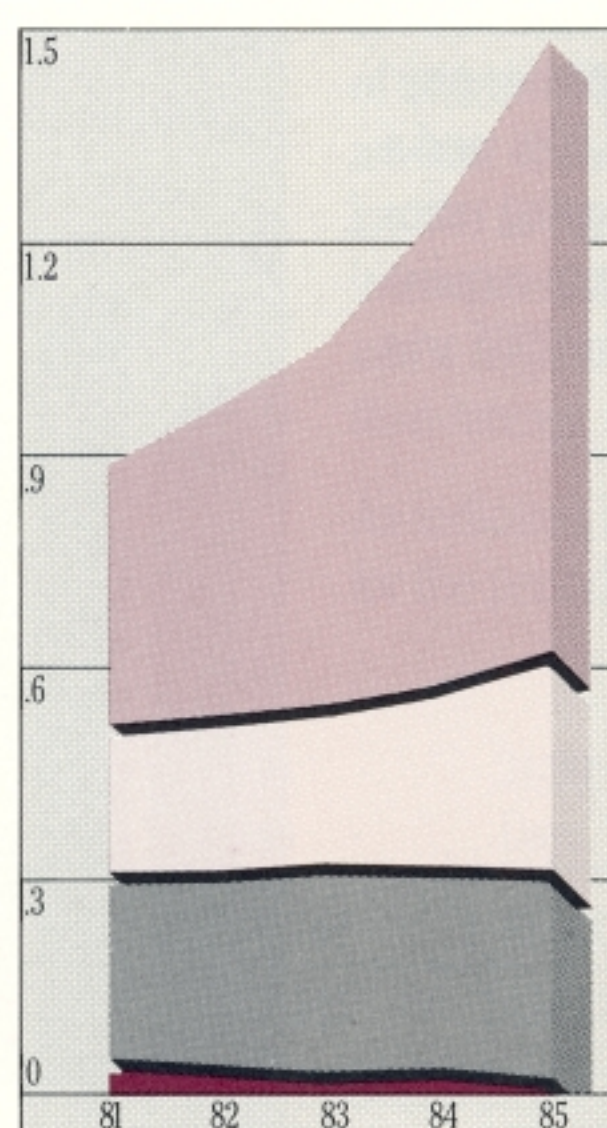
### Investment Portfolio

Book value at December 31:

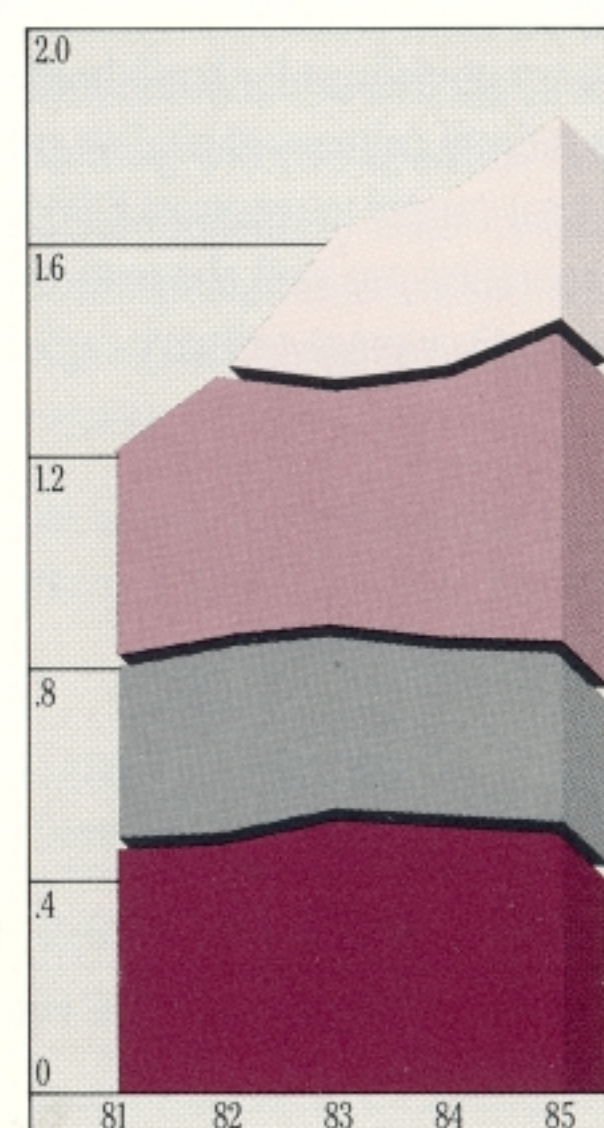
(In Thousands)	1985	1984	1983
U.S. Treasury and other U.S. Government agencies and corporations	\$125,169	\$223,060	\$233,546
State and political subdivisions	54,193	67,477	86,486
Other taxable securities	2,545	2,333	2,342
<b>Total</b>	<b>\$181,907</b>	<b>\$292,870</b>	<b>\$322,374</b>



**Earning Assets**  
(Average Dollars in Billions)  
■ Loans and Leases  
■ Investment Securities, Federal Funds Sold and Other



**Loans and Leases**  
(Average Dollars in Billions)  
■ Commercial  
■ Consumer  
■ Real Estate  
■ Leases



**Deposits**  
(Average Dollars in Billions)  
■ Money Market Accounts  
■ Time Deposits  
■ Savings and Interest Checking  
■ Non-Interest Bearing Demand



## Source of Funds

Loan growth was funded by the decrease in investment securities and the \$143.5 million or 8.5% increase in average deposits. At year-end, total deposits reached \$1.994 billion compared to a balance of \$1.787 billion at December 31, 1984.

Deposit growth was provided primarily by money market accounts, which were up \$67.0 million or 20.9%, and consumer time deposits, which grew \$56.9 million or 11.7%. Average time certificates over \$100,000 increased from \$39.9 million in 1984 to \$67.0 million in 1985 but remained an insignificant source of funds, representing only 3.7% of average deposits.

Non-interest bearing deposits declined \$9.5 million or 1.9% in 1985, while savings and interest bearing checking accounts increased \$2.0 million or .6%.

Historically, our large core deposit base has provided us with a low cost of funds relative to our peers. During the last five years, however, the cost of these funds has increased as consumers have shifted from non-interest bearing deposits and traditional savings accounts to higher-yielding market rate instruments.

As illustrated in the chart on page 9, non-interest bearing deposits have decreased from 39.1% of our deposit base in 1981 to 27.3% in 1985, and savings and interest bearing checking accounts have decreased from 28.8% to 18.3%. This change in deposit mix has had a material impact on our cost of funds and our net interest margin.

## Shareholders' Equity

Average shareholders' equity increased \$12.4 million or 10.1% in 1985 to \$135.0 million. By year-end, shareholders' equity totaled \$139.8 million, increasing \$10.9 million from year-end 1984.

During the last two years, we strengthened our capital position by controlling asset growth while building our capital base. Our primary source of capital in 1985 and 1984 was retained earnings, which increased \$10.5 million and \$11.3 million, respectively. Dividends paid to shareholders were \$3.8 million or \$1.00 per share in both years.

The current regulatory guidelines for bank holding companies prescribe a minimum ratio of primary capital to assets of 5.50% and a minimum ratio of total capital to assets of 6.00%. The capital ratios for Peoples Bancorporation are well above these minimum requirements. The corporation's average primary capital ratio for 1985 was

6.84%, up from 6.50% in 1984 and 6.15% in 1983. Our total capital ratio (which includes the Subordinated Capital Note and the Subordinated Convertible Debentures described in Note 6) was 7.07% for 1985, compared to 7.16% in 1984 and 6.89% in 1983. The decline in the total capital ratio from 1984 to 1985 reflects the maturity of the Series A Convertible Debentures and principal payments on the Subordinated Capital Note.

At December 31, 1985, our primary and total capital ratios were 6.61% and 6.78%, respectively.

## Liquidity

Maintaining adequate liquidity is an essential part of asset/liability management. Liquidity is defined as the ability to provide sufficient cash to fund operations and meet obligations and commitments on a timely basis.

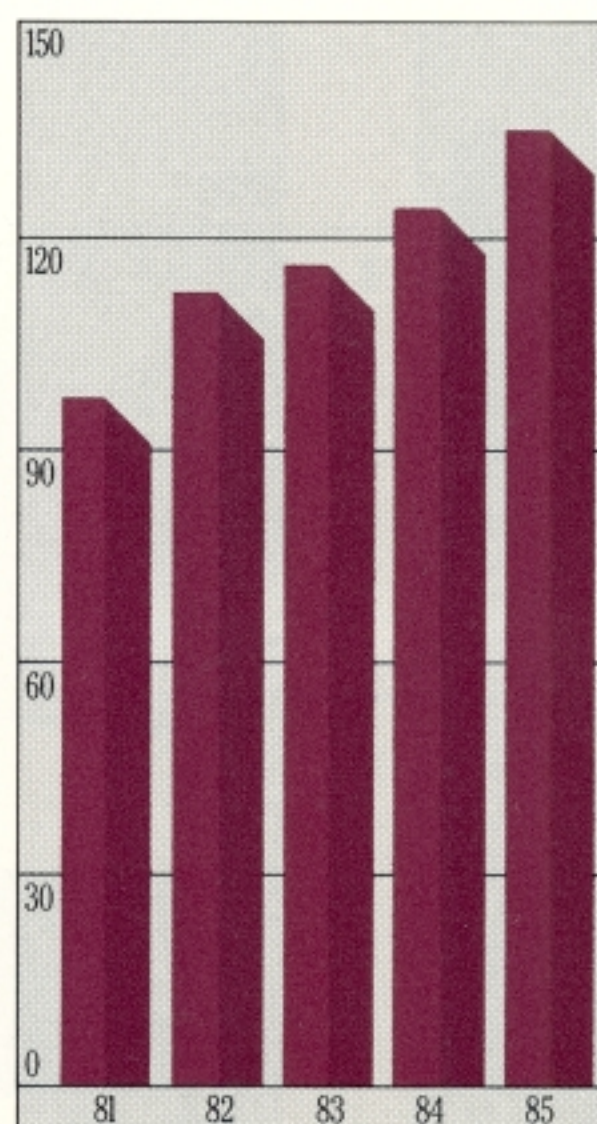
## Time Deposits of \$100,000 or More

Remaining maturities at December 31, 1985:

(In Thousands)

Maturities within 3 months	\$69,520
After 3 months but within 6 months	7,972
After 6 months but within 12 months	2,693
After 12 months	2,972
<b>Total</b>	<b>\$83,157</b>

Asset liquidity is provided through asset maturities, the sale of federal funds sold and security resale agreements, and the potential sale of marketable investment securities. Our investment security portfolio had a book value of \$181.9 million and a market value of \$179.9 million at December 31, 1985. As of year-end, \$83.3 million or 45.8% of the portfolio had remaining maturities of one year or less, and 39.3% of the portfolio had maturities between one and five years. At year-end, \$702.9 million or 58.7% of commercial and real estate loans had remaining maturities of one year or less, and



**Shareholders' Equity**  
(Average Dollars in Millions)



## Investment Portfolio

Remaining maturities at December 31, 1985:

(In Thousands)	U.S. Treasury and Other U.S. Government Agencies and Corporations		State and Political Subdivisions		Other Bonds, Notes and Debentures	
	Amount	Yield	Amount	Yield*	Amount	Yield
Maturities within 1 year	\$ 74,535	9.27 %	\$ 8,738	11.65 %	\$ —	— %
After 1 year but within 5	41,924	8.48	29,457	9.35	155	11.50
After 5 years but within 10	593	7.37	9,855	11.51	15	5.50
After 10 years	8,117	7.30	6,143	16.35	—	—
<b>Total**</b>	<b>\$125,169</b>	<b>8.87 %</b>	<b>\$54,193</b>	<b>10.91 %</b>	<b>\$ 170</b>	<b>10.97 %</b>

\* Weighted average yields on tax-exempt obligations were computed on a fully taxable equivalent basis assuming a tax rate of 46 %.

\*\*Excludes \$2,375,000 of equity holdings.

another 24.9% had maturities between one and five years. Federal funds sold and security resale agreements averaged \$129.8 million in 1985, with a balance of \$143.7 million at year-end.

Liability liquidity is defined as the ability to raise new funds and renew liabilities as they mature. The corporation's large core deposit base provides a very stable source of funds, which lessens the need

to raise funds in the large CD and federal fund markets. The ratio of average core deposits to total average deposits was 96.3% during 1985. At December 31, time deposits over \$100,000 were \$83.2 million or 4.2% of total deposits. The corporation's financial strength and large correspondent customer base enable it to raise additional funds as needed in the local and national markets.

## Remaining Maturity and Interest Rate Sensitivity of Selected Loans

December 31, 1985 (In Thousands)	Maturities			
	Within 1 Year	1 to 5 Years	After 5 Years	Total
Commercial, financial and agricultural	\$646,433	\$240,354	\$ 61,830	\$ 948,617
Real estate construction	29,977	—	—	29,977
Real estate mortgage	26,474	57,573	135,216	219,263
<b>Total*</b>	<b>\$702,884</b>	<b>\$297,927</b>	<b>\$197,046</b>	<b>\$1,197,857</b>
Loans with predetermined rates	\$130,184	\$160,424	\$150,295	\$ 440,903
Loans with floating rates	572,700	137,503	46,751	756,954
<b>Total*</b>	<b>\$702,884</b>	<b>\$297,927</b>	<b>\$197,046</b>	<b>\$1,197,857</b>

\*Excludes loans for consumer purposes and lease financing.

## Interest Rate Sensitivity

The growth of interest sensitive liabilities and the increase in interest rate volatility has made the analysis of interest sensitivity a very important part of asset/liability management. The corporation's Asset/Liability Committee monitors the interest sensitivity position of the corporation on a regular basis.

In analyzing interest rate sensitivity, assets and liabilities are categorized based on the time periods in which they reprice. Repricing

occurs either due to maturity or because rates are tied to market rates of interest. The difference between the amount of assets and the amount of liabilities repricing within a specified time period is known as the "Interest Rate Sensitivity Gap." A positive gap indicates interest sensitive assets are greater than interest sensitive liabilities, and a negative gap arises when interest sensitive liabilities are greater than interest sensitive assets.

As indicated in the table below, the corporation had a positive gap for the period of 0-30 days of \$399.5 million. For the total period of

## Interest Rate Sensitivity Analysis

December 31, 1985 (In Thousands)	0-30 Days	31-90 Days	91-180 Days	181-365 Days	Over 1 Year	Total
Total earning assets	\$1,066,744	\$ 61,700	\$ 48,603	\$ 58,998	\$ 686,986	\$1,923,031
Total interest bearing liabilities	667,245	143,637	144,968	129,481	491,629	1,576,960
Non-interest bearing sources of funds	—	—	—	—	346,071	346,071
Total sources of funds for earning assets	667,245	143,637	144,968	129,481	837,700	1,923,031
<b>Interest sensitivity gap</b>	<b>\$ 399,499</b>	<b>\$ (81,937)</b>	<b>\$ (96,365)</b>	<b>\$ (70,483)</b>	<b>\$ (150,714)</b>	<b>\$ —</b>
<b>Cumulative gap</b>	<b>\$ 399,499</b>	<b>\$317,562</b>	<b>\$221,197</b>	<b>\$150,714</b>	<b>\$ —</b>	<b>\$ —</b>



one year or less, interest sensitive assets exceeded interest sensitive liabilities by \$150.7 million. This short-term positive gap reflects our large base of non-interest bearing deposits and non-rate sensitive savings accounts. Our short-term gap became more positive in 1985, primarily due to the growth in floating rate commercial loans.

### Credit Risk Management

Peoples Bancorporation maintains a system of credit quality control which includes careful screening and analysis of all potential credits, monitoring the continuing soundness of credits and close review and evaluation for problem credits in order to minimize losses.

It is the corporation's policy to maintain a diversified portfolio and to limit foreign exposure. No single industry constitutes more than 10% of the loan portfolio and foreign credits represent less than 1% of outstanding loans. At December 31, 1985, foreign loans totaled \$7.5 million compared to \$11.0 million at year-end 1984. Loans to Mexico decreased from \$9.0 million to \$5.5 million, while outstandings to Brazil remained at \$2.0 million. At year-end, we also had \$22.0 million of acceptances outstanding to U.S. branches of Korean banks.

Our system of credit quality control also includes the examination of off-balance credit risk, such as standby letters of credit, foreign exchange commitments and loan commitments, to insure that these items do not have potential for future losses.

### Allocation of Allowance for Possible Credit Losses to Loan and Lease Categories

December 31 (In Millions)	1985		1984		1983		1982		1981	
	\$	%	\$	%	\$	%	\$	%	\$	%
<b>Allowance for Possible Credit Losses</b>										
Commercial, financial and agricultural	\$ 7.6	40.5%	\$ 4.3	28.7%	\$ 4.5	42.1%	\$ 4.7	45.2%	\$3.8	39.2%
Real estate construction	0.5	2.6	1.1	7.3	—	—	—	—	—	—
Real estate mortgage	2.6	14.0	1.9	12.7	2.0	18.7	2.0	19.2	1.7	17.5
Consumer	5.4	29.0	3.4	22.7	3.2	29.9	2.9	27.9	3.2	33.0
Lease financing	0.3	1.4	0.3	2.0	0.6	5.6	0.5	4.8	0.6	6.2
Unallocated	2.3	12.5	4.0	26.6	0.4	3.7	0.3	2.9	0.4	4.1
<b>Total</b>	<b>\$18.7</b>	<b>100.0%</b>	<b>\$15.0</b>	<b>100.0%</b>	<b>\$10.7</b>	<b>100.0%</b>	<b>\$10.4</b>	<b>100.0%</b>	<b>\$9.7</b>	<b>100.0%</b>
<b>Loan and Lease Categories (by Purpose) as a Percentage of Total Loans and Leases</b>										
Commercial, financial and agricultural		60.5%		56.3%		50.6%		47.7%		43.2%
Real estate construction		1.9		2.3		3.0		2.0		3.0
Real estate mortgage		14.0		18.0		22.1		25.4		26.2
Consumer		21.7		21.3		22.2		22.5		23.9
Lease financing		2.3		2.7		2.8		3.3		5.0
Less unearned income		(0.4)		(0.6)		(0.7)		(0.9)		(1.3)
<b>Total</b>		<b>100.0%</b>		<b>100.0%</b>		<b>100.0%</b>		<b>100.0%</b>		<b>100.0%</b>

### Credit Losses

The allowance for possible credit losses is maintained at a level which management considers to be adequate to cover future loan and lease losses. Management's assessment of future losses is based on a number of different factors which include known deterioration in the portfolio, volumes and trends in delinquencies and non-accruals, historical loss experience, local and national economic conditions, and trends in portfolio volume and composition. Based on management's analysis, the allowance for credit losses of \$18.7 million at December 31, 1985 was sufficient to cover the estimated potential losses in the portfolio. The ratio of the allowance to loans and leases outstanding at December 31 was 1.20%, increasing from 1.08% a year ago.

The table above presents an allocation of the allowance for credit losses to the major categories of loans and leases for the past five years. It should be noted, however, that the allowance is a composite reserve available for all types of loans and leases. It should not be construed that the indicated amount for each category is the maximum amount available for loans and leases in that category.

The allowance for possible credit losses is increased by provisions charged to expenses and reduced by net charge-offs. The provision for credit losses charged against earnings was \$11.7 million in 1985, increasing \$2.7 million or 30.9% in comparison to 1984. The provision exceeded net charge-offs by \$3.7 million, thereby increasing the allowance by that same amount.

Net charge-offs were \$7.9 million or .53% of average loans and leases in 1985 compared to \$4.6 million or .37% of average loans and leases in 1984. We experienced a significantly higher level of losses on both commercial and consumer loans. Net charge-offs on commercial loans (including financial and agricultural loans) totaled \$4.4 million or .51% of the average commercial portfolio in 1985 compared to \$1.9 million or .28% of the average portfolio in 1984. The increase in losses could not be attributed to any single industry or group of loans. Net losses on consumer loans increased from \$1.1 million or .43% of average consumer loans in 1984 to \$2.6 million or .81% of average consumer loans in 1985. Net charge-offs on credit cards increased from 1.05% to 1.77% of average credit card balances while net charge-offs on other types of consumer loans increased from .36% to .66% of average balances.



## Summary of Loan Loss Experience

(In Thousands)	1985	1984	1983	1982	1981
<b>Allowance for Possible Credit Losses</b>					
Balance at beginning of year	\$15,005	\$10,697	\$10,432	\$ 9,682	\$ 8,655
Charge-offs:					
Commercial, financial and agricultural	5,240	3,115	4,387	3,272	1,885
Real estate construction	195	1,121	—	—	—
Real estate mortgage	399	646	678	371	287
Consumer	3,744	1,908	2,554	1,903	1,449
Lease financing	450	25	777	921	807
Total	10,028	6,815	8,396	6,467	4,428
Recoveries:					
Commercial, financial and agricultural	793	1,209	995	628	930
Real estate construction	—	—	—	—	—
Real estate mortgage	—	10	127	26	35
Consumer	1,184	761	1,135	634	454
Lease financing	139	242	305	245	156
Total	2,116	2,222	2,562	1,533	1,575
Net charge-offs	7,912	4,593	5,834	4,934	2,853
Provision charged against earnings	11,650	8,901	6,099	5,684	3,880
<b>Balance at end of year</b>	<b>\$18,743</b>	<b>\$15,005</b>	<b>\$10,697</b>	<b>\$10,432</b>	<b>\$ 9,682</b>
Loans and leases outstanding at December 31 (net of unearned income)	\$1,566,543	\$1,395,484	\$1,082,632	\$1,064,190	\$933,371
Average loans and leases outstanding (net of unearned income)	1,494,565	1,245,157	1,066,155	979,971	892,132
Ratio of net charge-offs to average loans and leases	.53%	.37%	.55%	.50%	.32%
Ratio of allowance for possible credit losses to loans and leases outstanding at December 31	1.20	1.08	.99	.98	1.04

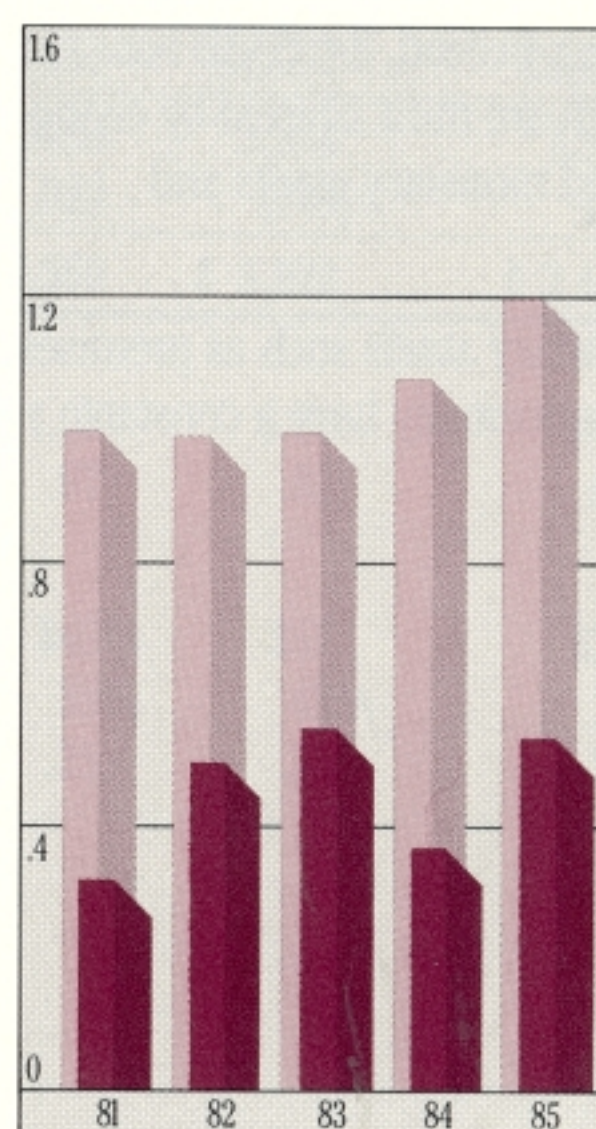
### Non-Performing Assets

Non-performing assets totaled \$38.8 million or 1.6% of total assets at December 31, 1985, increasing from \$22.8 million or 1.0% of total assets at December 31, 1984. Non-performing loans increased \$13.5 million from 1.2% to 1.9% of total outstanding loans and leases. Non-accrual loans were \$27.0 million at year-end 1985 compared to \$14.7 million at year-end 1984.

It is management's policy to place a credit on non-accrual status whenever circumstances indicate that collection is questionable. At the time an asset is placed on non-accrual status, any interest income previously accrued but uncollected is reversed against earnings.

It should be noted that non-performing status does not necessarily indicate an anticipated loss or ultimate loss of interest, as assets in this category are generally well-secured by collateral or guaranties.

As of December 31, 1985, there were \$2.4 million of loans which were not included in any category under non-performing assets, but about which management has concerns regarding the continuing ability of the borrower to comply with present loan repayment terms. These loans are being monitored very closely by management and their classification is reviewed on a regular basis. There are currently no commitments to lend additional funds to customers whose loans were classified as non-performing at December 31, 1985.



**Credit Losses**

(Percent)

■ Allowance to Year-End Loans and Leases

■ Net Charge-Offs to Average Loans and Leases



The interest income which would have been recorded during 1985 under original terms on loans and leases which were on non-accrual status at year-end totaled \$4.7 million. The interest income actually

recorded on such loans during 1985 was \$2.0 million. The total effect of interest income lost on all non-performing assets in 1985 was a reduction in the net interest margin of approximately 15 basis points.

### Non-Performing Assets and Past Due Loans and Leases

December 31 (In Thousands)	1985	1984	1983	1982	1981
Non-performing loans and leases:					
Non-accrual	\$26,967	\$14,665	\$17,642	\$ 7,212	\$ 6,401
Real estate in process of foreclosure	3,175	1,957	3,489	4,724	—
Total	30,142	16,622	21,131	11,936	6,401
Other real estate owned	8,668	6,152	10,556	4,566	1,759
Total non-performing assets	\$38,810	\$22,774	\$31,687	\$16,502	\$ 8,160
Loans and leases past due 90 days or more	\$ 9,205	\$ 4,735	\$ 6,700	\$10,855	\$12,040

### Supplemental Information on the Effects of Changing Prices

#### Basis of Presentation

As required by Financial Accounting Standards Board (FASB) Statement No. 33, "Financial Reporting and Changing Prices," the following information is presented concerning the effects of changing prices on the financial statements.

Statement No. 33 requires the adjustment of key historical data for the effects of specific price changes (current cost), or for the effects of general inflation (constant dollar), in cases where current cost information is unavailable. The financial data below is presented on a constant dollar basis, and there was no material difference between the effects of general inflation and the effects of specific price changes.

As specified by Statement No. 33, no adjustments to or allocation of the amount of income tax expense in the primary financial statements were made in the computation of the supplemental information.

#### Impact of Changing Prices on Historical Financial Data

The FASB does not require each financial statement item to be restated for the impact of changing prices. Instead, the FASB has focused disclosures on those items which are most affected by changing prices—premises and equipment and monetary assets and liabilities.

In periods of general inflation, non-monetary assets such as premises and equipment purchased in prior years normally have a constant

dollar value higher than their nominal dollar value. Depreciation expense based on these constant dollar values would accordingly be higher. For 1985, the effect of restating non-monetary assets on a constant dollar basis using the 1985 average Consumer Price Index (CPI) would have been an increase to depreciation expense of \$1,823,000.

Inflation will also impact the purchasing power of net monetary assets. In 1985, the corporation experienced a loss in the purchasing power of its net monetary assets of \$2,320,000. This was computed by determining the difference between the monetary assets at the beginning and end of 1985, after conversion into average dollars using the average CPI for 1985.

It should be noted that a bank's asset and liability structure is substantially different from that of an industrial company, in that virtually all assets and liabilities of a bank are monetary in nature. Accordingly, changes in interest rates may have a significant impact on a bank's performance. Interest rates do not necessarily move in the same direction or magnitude as the prices of other goods and services.

#### Statement of Income Adjusted for Changing Prices

Year Ended December 31, 1985 (In Thousands)	
Net income, as reported in the consolidated statement of income	\$14,267
Less increase in depreciation expense to reflect the effect of changing prices	(1,823)
Net income adjusted for changing prices	\$12,444



The table below presents comparative historical information which has been adjusted for the effect of general inflation by applying the average CPI for 1985 to the amount as originally reported.

### Five-Year Comparison of Selected Supplemental Financial Data Adjusted for the Effects of Changing Prices

Year Ended December 31 (In Thousands, Except Per Share)	1985	1984	1983	1982	1981
Net interest income	\$ 93,463	\$ 91,261	\$ 80,365	\$ 89,357	\$ 89,697
Net income	12,444	13,777	4,705	12,964	16,481
Net assets at year-end	173,342	167,193	160,446	163,537	160,823
Purchasing power loss from holding net monetary assets during the year	2,320	2,253	1,788	1,907	5,105
Per common share:					
Net income	3.30	3.66	1.24	3.39	4.32
Cash dividends declared	1.00	1.04	1.08	1.11	1.18
Market bid price (at year-end)	50.00	27.70	25.64	17.55	22.77
Average consumer price index for all urban consumers	322.2	311.4	298.5	289.2	272.5

### Quarterly Financial Information

Non-interest income for second and fourth quarters 1985 included gains of \$1.0 million and \$1.3 million, respectively, from the sale of mortgage loan servicing. (Income for the year from the sale of mortgage loan servicing was \$2.6 million.) In addition, fourth quarter 1985 included a \$1.4 million gain from the sale of our Dexter and Broad branch.

Fourth quarter 1984 non-interest income also included non-recurring gains: \$1.1 million from the sale of our former computer center and \$1.0 million from the sale of mortgage loan servicing. (Income for the

year from the sale of loan servicing was \$1.8 million.)

Peoples Bancorporation's common stock is traded in the over-the-counter market under the NASDAQ symbol PEOP and quoted daily in leading financial publications. There were approximately 1,648 shareholders of record as of December 31, 1985. The payment of dividends on common stock is subject to the restrictions described in Note 8.

The bid quotations below were compiled by the National Quotation Bureau, Inc.

### Quarterly Statements of Income and Common Stock Data

(In Thousands, Except Per Share)	1985				1984			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Interest income	\$50,934	\$51,912	\$51,771	\$51,664	\$47,599	\$50,542	\$54,563	\$53,885
Interest expense	28,575	28,246	28,050	27,947	28,581	28,342	30,883	30,666
Net interest income	22,359	23,666	23,721	23,717	19,018	22,200	23,680	23,219
Provision for possible credit losses	1,974	2,839	2,352	4,485	1,233	2,124	1,917	3,627
Non-interest income	11,476	11,841	11,682	13,399	10,037	10,520	11,113	12,848
Non-interest expense	26,953	28,097	28,353	30,097	25,504	26,161	26,770	27,207
Income before taxes	4,908	4,571	4,698	2,534	2,318	4,435	6,106	5,233
Income tax expense (benefit)	1,147	812	1,029	(544)	(96)	932	1,556	623
<b>Net income</b>	<b>\$ 3,761</b>	<b>\$ 3,759</b>	<b>\$ 3,669</b>	<b>\$ 3,078</b>	<b>\$ 2,414</b>	<b>\$ 3,503</b>	<b>\$ 4,550</b>	<b>\$ 4,610</b>
Net income per share:								
Primary	\$1.00	\$ .99	\$ .98	\$ .81	\$ .64	\$ .93	\$1.20	\$1.23
Fully diluted	.99	.99	.97	.81	.61	.89	1.15	1.17
Market bid price:								
High	\$31 <sup>3</sup> / <sub>4</sub>	\$40 <sup>1</sup> / <sub>2</sub>	\$42 <sup>3</sup> / <sub>4</sub>	\$57	\$24 <sup>1</sup> / <sub>2</sub>	\$25 <sup>1</sup> / <sub>2</sub>	\$24 <sup>1</sup> / <sub>2</sub>	\$26 <sup>3</sup> / <sub>4</sub>
Low	26 <sup>3</sup> / <sub>4</sub>	31 <sup>3</sup> / <sub>4</sub>	39 <sup>3</sup> / <sub>4</sub>	42 <sup>3</sup> / <sub>4</sub>	21 <sup>1</sup> / <sub>2</sub>	20 <sup>1</sup> / <sub>4</sub>	20	24 <sup>1</sup> / <sub>4</sub>
Dividends declared per share	.25	.25	.25	.25	.25	.25	.25	.25



Average Balances/Interest Income and Expense/Rates

(In Thousands)	1985			1984		1983			
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
<b>Assets</b>									
Investment securities:									
Taxable	\$ 137,541	\$ 14,007	10.18 %	\$ 215,415	\$ 22,273	10.34 %	\$ 232,398	\$ 25,133	10.81 %
Non-taxable	54,210	5,637	10.40	78,541	8,593	10.94	93,112	10,196	10.95
Total investment securities	191,751	19,644	10.24	293,956	30,866	10.50	325,510	35,329	10.85
Interest bearing deposits with banks	—	—	—	246	27	11.18	247	28	11.15
Trading account assets	34,981	3,255	9.31	21,152	2,463	11.64	15,746	1,767	11.22
Federal funds sold and security resale agreements	129,753	10,560	8.14	131,401	13,661	10.40	249,598	22,828	9.15
Loans and leases:									
Commercial	876,092	100,046	11.42	675,799	89,876	13.30	520,538	62,772	12.06
Consumer	316,213	39,887	12.61	264,815	35,846	13.54	231,013	30,198	13.07
Real estate	272,774	29,363	10.76	278,045	29,648	10.66	290,230	30,404	10.48
Lease financing	29,486	2,979	10.10	26,498	3,001	11.33	24,374	3,180	13.05
Total loans and leases	1,494,565	172,275	11.53	1,245,157	158,371	12.72	1,066,155	126,554	11.87
Loan fees		8,189	.55		8,614	.69		6,671	.63
Total—including loan fees	1,494,565	180,464	12.08	1,245,157	166,985	13.41	1,066,155	133,225	12.50
Total earning assets	1,851,050	\$213,923	11.55 %	1,691,912	\$214,002	12.65 %	1,657,256	\$193,177	11.66 %
Less allowance for possible credit losses	(16,467)			(12,365)			(10,390)		
Cash and due from banks	220,763			234,581			264,964		
Other non-earning assets	143,028			148,968			134,201		
<b>Total Assets</b>	<b>\$2,198,374</b>			<b>\$2,063,096</b>			<b>\$2,046,031</b>		
<b>Liabilities and Shareholders' Equity</b>									
Interest bearing deposits:									
Savings and interest checking	\$ 335,493	\$ 17,898	5.33 %	\$ 333,495	\$ 17,849	5.35 %	\$ 350,626	\$ 18,383	5.24 %
Money market accounts	386,752	26,622	6.88	319,792	27,598	8.63	289,075	23,369	8.08
Time certificates over \$100,000	66,982	5,572	8.32	39,892	4,271	10.71	31,403	2,654	8.45
Other time deposits	543,290	50,238	9.25	486,410	50,063	10.29	433,707	45,582	10.51
Total interest bearing deposits	1,332,517	100,330	7.53	1,179,589	99,781	8.46	1,104,811	89,988	8.15
Federal funds purchased and security repurchase agreements	140,452	9,983	7.11	151,677	14,383	9.48	186,865	15,675	8.39
Other short-term borrowings	18,386	1,605	8.73	20,145	2,120	10.52	43,652	3,956	9.06
Long-term debt	9,234	900	9.74	20,650	2,188	10.59	21,502	1,944	9.04
Total interest bearing liabilities	1,500,589	\$112,818	7.52 %	1,372,061	\$118,472	8.63 %	1,356,830	\$111,563	8.22 %
Non-interest bearing deposits	500,021			509,497			521,202		
Other liabilities	62,778			58,932			51,950		
Shareholders' equity	134,986			122,606			116,049		
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$2,198,374</b>			<b>\$2,063,096</b>			<b>\$2,046,031</b>		
Yield on earning assets		\$213,923	11.55 %		\$214,002	12.65 %		\$193,177	11.66 %
Interest expense related to earning assets		112,818	6.09		118,472	7.00		111,563	6.73
<b>Net Interest Margin</b>		<b>\$101,105</b>	<b>5.46 %</b>		<b>\$ 95,530</b>	<b>5.65 %</b>		<b>\$ 81,614</b>	<b>4.93 %</b>

The above table is presented on a fully taxable equivalent basis assuming a 46 % income tax rate. Non-accrual loans are included in average loan balances. Changes in net interest margin not due solely to changes in volume or rate have been allocated to rate.

Analysis of Changes in Net Interest Margin

Year Ended 1985 over 1984			Year Ended 1984 over 1983		
Volume	Rate	Total	Volume	Rate	Total
\$ (8,052)	\$ (214)	\$ (8,266)	\$ (1,837)	\$(1,023)	\$(2,860)
(2,662)	(294)	(2,956)	(1,596)	(7)	(1,603)
(10,714)	(508)	(11,222)	(3,433)	(1,030)	(4,463)
(27)	—	(27)	(1)	—	(1)
1,609	(817)	792	608	88	696
(171)	(2,930)	(3,101)	(10,810)	1,643	(9,167)
26,637	(16,467)	10,170	18,723	8,381	27,104
6,957	(2,916)	4,041	4,419	1,229	5,648
(562)	277	(285)	(1,276)	520	(756)
338	(360)	(22)	277	(456)	(179)
33,370	(19,466)	13,904	22,143	9,674	31,817
1,725	(2,150)	(425)	1,120	823	1,943
35,095	(21,616)	13,479	23,263	10,497	33,760
\$ 25,792	\$(25,871)	\$ (79)	\$ 9,627	\$11,198	\$20,825
\$ 107	\$ (58)	\$ 49	\$ (898)	\$ 364	\$ (534)
5,779	(6,755)	(976)	2,483	1,746	4,229
2,900	(1,599)	1,301	717	900	1,617
5,853	(5,678)	175	5,540	(1,059)	4,481
14,639	(14,090)	549	7,842	1,951	9,793
(1,064)	(3,336)	(4,400)	(2,952)	1,660	(1,292)
(185)	(330)	(515)	(2,130)	294	(1,836)
(1,209)	(79)	(1,288)	(77)	321	244
\$ 12,181	\$(17,835)	\$ (5,654)	\$ 2,683	\$ 4,226	\$ 6,909
\$ 13,611	\$ (8,036)	\$ 5,575	\$ 6,944	\$ 6,972	\$13,916



Peoples Bancorporation and Subsidiaries  
**Consolidated Balance Sheets**

December 31 (In Thousands)	1985	1984
<b>Assets</b>		
Cash and due from banks	\$ 332,819	\$ 223,050
Investment securities (market value of \$179,928 and \$289,050, respectively)—Note 2	181,907	292,870
Trading account assets	30,921	39,068
Federal funds sold and security resale agreements	143,660	83,510
Loans and leases (net of unearned income of \$6,941 and \$8,289, respectively)—Note 3	1,566,543	1,395,484
Allowance for possible credit losses—Note 4	(18,743)	(15,005)
Net loans and leases	1,547,800	1,380,479
Premises and equipment—Note 5	53,759	54,356
Due from customers on acceptances	34,899	40,014
Other assets	54,576	59,986
<b>Total Assets</b>	<b>\$2,380,341</b>	<b>\$2,173,333</b>
<b>Liabilities and Shareholders' Equity</b>		
Deposits:		
Non-interest bearing	\$ 600,872	\$ 534,990
Interest bearing	1,393,118	1,251,561
Total deposits	1,993,990	1,786,551
Federal funds purchased and security repurchase agreements	144,695	159,438
Other short-term borrowings	31,163	24,186
Acceptances outstanding	34,899	40,014
Other liabilities	27,860	23,804
Long-term debt—Note 6	7,984	10,451
<b>Total Liabilities</b>	<b>2,240,591</b>	<b>2,044,444</b>
<b>Shareholders' Equity</b>		
Common stock (par value \$5)—authorized 10,000,000 shares, issued 3,845,696 shares and 3,830,108 shares, respectively—Note 7	19,229	19,151
Surplus	23,646	23,220
Retained earnings	98,066	87,575
	140,941	129,946
Less common stock in treasury, at cost—64,200 shares and 60,000 shares, respectively	(1,191)	(1,057)
<b>Total Shareholders' Equity</b>	<b>139,750</b>	<b>128,889</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$2,380,341</b>	<b>\$2,173,333</b>

See notes to consolidated financial statements.



Peoples Bancorporation and Subsidiaries  
**Consolidated Statements of Income**

Year Ended December 31 (In Thousands, Except Per Share)	1985	1984	1983
<b>Interest Income</b>			
Interest and fees on loans and leases	\$176,163	\$164,130	\$131,196
Interest on deposits with banks	—	27	28
Interest on federal funds sold and security resale agreements	10,560	13,661	22,828
Interest on investment securities:			
Taxable	14,007	22,273	25,133
Exempt from federal income taxes	3,044	4,640	5,506
Interest on trading account assets	2,507	1,858	1,301
<b>Total Interest Income</b>	<b>206,281</b>	<b>206,589</b>	<b>185,992</b>
<b>Interest Expense</b>			
Interest on deposits	100,330	99,781	89,988
Interest on federal funds purchased and security repurchase agreements	9,983	14,383	15,675
Interest on short-term borrowings	1,605	2,120	3,956
Interest on long-term debt	900	2,188	1,944
<b>Total Interest Expense</b>	<b>112,818</b>	<b>118,472</b>	<b>111,563</b>
<b>Net Interest Income</b>	<b>93,463</b>	<b>88,117</b>	<b>74,429</b>
Provision for possible credit losses—Note 4	11,650	8,901	6,099
<b>Net Interest Income After Provision for Possible Credit Losses</b>	<b>81,813</b>	<b>79,216</b>	<b>68,330</b>
<b>Non-Interest Income</b>			
Trust fees and commissions	6,058	5,483	4,705
Service charges on deposit accounts	13,232	13,041	11,765
Securities gains (losses)	629	10	(102)
Other	28,479	25,984	21,084
<b>Total Non-Interest Income</b>	<b>48,398</b>	<b>44,518</b>	<b>37,452</b>
<b>Non-Interest Expense</b>			
Salaries	49,075	43,989	43,388
Employee benefits—Note 9	10,272	9,984	9,325
Occupancy—Note 5	7,349	6,439	5,636
Furniture and equipment—Note 5	10,609	11,609	11,317
Other	36,195	33,621	32,811
<b>Total Non-Interest Expense</b>	<b>113,500</b>	<b>105,642</b>	<b>102,477</b>
Income before income taxes	16,711	18,092	3,305
Income tax expense (benefit)—Note 10	2,444	3,015	(2,727)
<b>Net Income</b>	<b>\$ 14,267</b>	<b>\$ 15,077</b>	<b>\$ 6,032</b>
<b>Net Income Per Share:</b>			
Primary	\$3.78	\$4.00	\$1.59
Fully diluted	3.76	3.81	1.56

See notes to consolidated financial statements.



**Consolidated Statements of Changes in Financial Position**

Year Ended December 31 (In Thousands)	1985	1984	1983
<b>Financial resources were provided by (applied to):</b>			
Operations:			
Net income	\$ 14,267	\$ 15,077	\$ 6,032
Non-cash charges (credits):			
Depreciation and amortization	7,770	8,942	9,375
Provision for possible credit losses	11,650	8,901	6,099
Deferred tax expense (benefit)	(1,810)	(1,066)	2,779
Financial resources provided by operations	31,877	31,854	24,285
Cash dividends paid	(3,772)	(3,775)	(3,789)
Deposits and other financing activities:			
Deposits:			
Non-interest bearing	65,882	(48,147)	60,034
Interest bearing	141,557	90,649	189,852
Total deposits	207,439	42,502	249,886
Federal funds purchased and security repurchase agreements	(14,743)	123,717	(209,808)
Other short-term borrowings	6,977	3,086	(33,536)
Long-term debt	(1,963)	(11,972)	1,998
Treasury stock acquisitions	(134)	(329)	(555)
Total financing activities	197,576	157,004	7,985
Other activities—(increase) decrease in non-earning assets and liabilities:			
Cash and due from banks	(109,769)	61,556	(35,545)
Premises and equipment	(5,508)	(6,825)	(5,784)
Other, net	10,234	4,434	(31,486)
Total other activities	(105,043)	59,165	(72,815)
<b>Increase (decrease) in financial resources invested in earning assets</b>	<b>\$ 120,638</b>	<b>\$244,248</b>	<b>\$ (44,334)</b>
<b>Increase (decrease) in earning assets:</b>			
Interest bearing deposits with banks	\$ —	\$ (45,000)	\$ 45,000
Investment securities	(110,192)	(27,432)	32,314
Trading account assets	(8,147)	21,567	(15,131)
Federal funds sold and security resale agreements	60,150	(22,064)	(130,332)
Loans and leases	178,827	317,177	23,815
<b>Increase (decrease) in earning assets</b>	<b>\$ 120,638</b>	<b>\$244,248</b>	<b>\$ (44,334)</b>

**Consolidated Statements of Changes in Shareholders' Equity**

(In Thousands)	Common Stock	Surplus	Retained Earnings	Treasury Stock	Total
<b>Balance at December 31, 1982</b>	\$19,135	\$23,148	\$74,018	\$ (173)	\$116,128
Net income	—	—	6,032	—	6,032
Cash dividends declared (\$1.00 per share)	—	—	(3,780)	—	(3,780)
Treasury stock acquired	—	—	—	(555)	(555)
Conversion of convertible debentures to common stock	4	16	—	—	20
<b>Balance at December 31, 1983</b>	19,139	23,164	76,270	(728)	117,845
Net income	—	—	15,077	—	15,077
Cash dividends declared (\$1.00 per share)	—	—	(3,772)	—	(3,772)
Treasury stock acquired	—	—	—	(329)	(329)
Conversion of convertible debentures to common stock	12	56	—	—	68
<b>Balance at December 31, 1984</b>	19,151	23,220	87,575	(1,057)	128,889
Net income	—	—	14,267	—	14,267
Cash dividends declared (\$1.00 per share)	—	—	(3,776)	—	(3,776)
Treasury stock acquired	—	—	—	(134)	(134)
Conversion of convertible debentures to common stock	78	426	—	—	504
<b>Balance at December 31, 1985</b>	<b>\$19,229</b>	<b>\$23,646</b>	<b>\$98,066</b>	<b>\$ (1,191)</b>	<b>\$139,750</b>

See notes to consolidated financial statements.



**Note 1—Summary of Significant Accounting Policies**

The accounting and reporting policies of Peoples Bancorporation (the "corporation") and its subsidiaries conform to generally accepted accounting principles and to predominant practice within the banking industry. The following is a description of significant accounting policies:

**Consolidation:** The consolidated financial statements of Peoples Bancorporation include the accounts of the corporation and its wholly-owned subsidiaries, including Peoples National Bank of Washington (the "bank"), the corporation's principal subsidiary. Significant inter-company transactions and balances are eliminated. Certain amounts in the 1983 and 1984 financial statements have been reclassified to conform with the 1985 presentation.

**Investment Securities:** Investment securities are carried at cost, adjusted for amortization of premiums and accretion of discounts. Gains and losses on the sale of securities are computed principally on the specific identification method.

Trading account assets are carried at market value.

**Loans and Leases:** Interest on commercial, real estate and certain types of consumer loans is accrued and credited to income based upon the principal amount outstanding. Interest on other consumer loans is accrued and credited to income on the sum-of-the-month's-digits method.

It is the policy of management to discontinue the accrual of interest on loans and leases when circumstances indicate that collection is questionable. At the time an asset is placed on non-accrual status, the accrued and unpaid interest is reversed against current income.

Material loan fees in excess of estimated costs are deferred and amortized to income over the estimated terms of the loans except certain construction loan fees which are deferred and recognized as income based on the percentage of loan disbursements made.

The financing method of accounting is used for direct lease contract receivables. Under this method, income is recognized during the term of the lease in proportion to the unrecovered investment.

Real estate held for resale, acquired principally through foreclosure, is carried at the lower of cost or market value and is included in other assets.

**Allowance for Possible Credit Losses:** The allowance for possible credit losses is increased by provisions charged to expenses and reduced by loans and leases charged off, net of recoveries. The allowance is based on management's evaluation of potential losses in the loan and lease portfolio after consideration of historical loss experience, current problem credits, economic conditions and other risks inherent in the portfolio.

**Premises and Equipment:** Premises and equipment are stated at cost less accumulated depreciation and amortization, which are computed on the straight-line and accelerated methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is less. Gains or losses on dispositions are reflected in earnings.

**Intangibles:** Deposit intangibles recorded in purchase transactions are amortized on a straight-line basis over lives ranging from 6 months to 4 years; safe deposit box intangibles are amortized on a straight-line basis over 20 years; and goodwill is amortized over periods ranging from 15 years to 40 years on a straight-line basis.

Net intangibles were \$8,344,000 and \$9,093,000 at December 31, 1985 and 1984, respectively, including accumulated amortization of \$6,612,000 and \$5,863,000 at December 31, 1985 and 1984, respectively.

**Mortgage Commitments:** Gains or losses on mortgage standby contracts and mortgage forward contracts are recognized when the transactions are consummated. Standby contract fees are recognized as an expense when loans are delivered, the standby period expires or when a determination has been made that the standby contract will not be used.

**Trust Income:** Income from trust services is recognized on the cash basis in accordance with predominant industry practice. The results of trust operations would not be materially different if reported on the accrual method.

**Income Taxes:** The provision for income taxes is based on income and expense reported for financial statement purposes after adjustment for permanent differences (principally tax-exempt income) and tax credits. Deferred income taxes are provided on timing differences when income and expenses are recognized in different periods for financial and income tax reporting purposes. Investment tax credits related to assets acquired for use by the corporation and subsidiaries are accounted for under the flow through method which recognizes the benefit in the year in which the asset is placed in service. Investment tax credits relating to certain equipment leases are amortized over the terms of the respective leases.

**Earnings Per Share:** Primary earnings per share are computed based on the weighted average number of shares outstanding during the year, which were 3,772,975 in 1985, 3,773,374 in 1984 and 3,784,694 in 1983. Per share amounts on a fully diluted basis assume conversion of all outstanding convertible debentures and elimination of related interest expense net of the applicable income tax effect. The computations exclude shares issuable under stock grants and stock options because their effect would not be material.



## Note 2—Investment Securities

The following table reflects the book and market values of investment securities at December 31:

(In Thousands)	1985		1984	
	Book	Market	Book	Market
U.S. Treasury and other U.S. Government agencies and corporations	\$125,169	\$125,506	\$223,060	\$223,668
State and political subdivisions	54,193	51,764	67,477	63,073
Other taxable securities	2,545	2,658	2,333	2,309
<b>Total investment securities</b>	<b>\$181,907</b>	<b>\$179,928</b>	<b>\$292,870</b>	<b>\$289,050</b>

Securities carried at approximately \$53,898,000 and \$49,714,000 at December 31, 1985 and 1984, respectively, were pledged to secure public deposits and trust funds and for other purposes required by law.

## Note 3—Loans and Leases

Loans and leases by purpose at December 31 consisted of the following:

(In Thousands)	1985	1984
Commercial, financial and agricultural	\$ 948,617	\$ 785,488
Real estate construction	29,977	32,892
Real estate mortgage	219,263	251,523
Consumer	339,344	296,775
Lease financing	36,283	37,095
Less unearned income	(6,941)	(8,289)
<b>Total loans and leases</b>	<b>\$1,566,543</b>	<b>\$1,395,484</b>

Certain related parties of Peoples Bancorporation, principally directors of the corporation and their associates, were loan customers of the corporation and its subsidiaries in the ordinary course of business during 1985 and 1984. Activity related to these loans during 1985 was as follows:

(In Thousands)	
Balance at December 31, 1984	\$ 17,918
New loans	687,118
Repayments	696,829
<b>Balance at December 31, 1985</b>	<b>\$ 8,207</b>

The average balance of loans outstanding to related parties during 1985 approximated \$13 million. The new loans and repayments shown above reflect frequently recurring transactions under existing lines of credit.

## Note 4—Allowance for Possible Credit Losses

Changes in the allowance for possible credit losses for the years ended December 31, 1985, 1984, and 1983 were as follows:

(In Thousands)	1985	1984	1983
Balance at beginning of year	\$15,005	\$10,697	\$10,432
Provision charged against earnings	11,650	8,901	6,099
Charge-offs	(10,028)	(6,815)	(8,396)
Recoveries	2,116	2,222	2,562
<b>Net charge-offs</b>	<b>(7,912)</b>	<b>(4,593)</b>	<b>(5,834)</b>
<b>Balance at December 31</b>	<b>\$18,743</b>	<b>\$15,005</b>	<b>\$10,697</b>

## Note 5—Premises and Equipment

The components of premises and equipment at December 31 were as follows:

(In Thousands)	1985	1984
Land	\$ 8,990	\$ 8,557
Buildings	39,899	40,462
Leasehold improvements	9,650	8,552
Furniture and equipment	36,670	33,700
	95,209	91,271
Less accumulated depreciation and amortization	(41,450)	(36,915)
<b>Total premises and equipment</b>	<b>\$53,759</b>	<b>\$54,356</b>

Depreciation expense on premises and equipment totaled \$6,101,000, \$5,588,000 and \$5,420,000 for the years ended December 31, 1985, 1984 and 1983, respectively. Occupancy expense has been reduced by rental income received. Such income amounted to \$2,197,000, \$2,189,000 and \$2,122,000 for the years ended December 31, 1985, 1984 and 1983, respectively.

Rental expense of leased premises and equipment was \$6,532,000, \$7,840,000 and \$7,624,000 for the years ended December 31, 1985, 1984 and 1983, respectively. The corporation principally leases equipment and premises under operating leases.

Minimum net rental commitments under noncancellable leases having an original or remaining term of more than one year were as follows as of December 31, 1985:

(In Thousands)	
1986	\$ 4,249
1987	3,083
1988	2,096
1989	1,251
1990	1,057
1991 and subsequent	4,950
<b>Total minimum payments required</b>	<b>\$16,686</b>

Certain leases contain renewal options from 2 to 20 years and escalation clauses based upon increases in property taxes and other costs.



## Note 6—Long-Term Debt

Long-term debt at December 31 consisted of the following:

(In Thousands)	1985	1984
8¾ % Subordinated Capital Note	\$3,500	\$ 4,500
8¾ % Series B Subordinated Convertible Debentures	655	1,159
Mortgages payable and other contractual indebtedness	3,829	4,792
<b>Total long-term debt</b>	<b>\$7,984</b>	<b>\$10,451</b>

**Subordinated Capital Note:** A semiannual principal payment of \$500,000 is due on June 30, 1986. The remaining principal balance of \$3,000,000 is due on December 31, 1986. This note is unsecured and subordinated to the rights of depositors and other creditors except the holders of subordinated convertible debentures as discussed below.

**Subordinated Convertible Debentures:** The subordinated convertible debentures are due on December 15, 1989. They are convertible into common stock at the option of the holders. The conversion rate is the higher of (a) \$13.375 per share or (b) 95% of the consolidated book value per share at the end of the most recent calendar quarter, less the unamortized excess of the purchase price over the net assets acquired reestablished on the books of the parent company at the time of its formation. At December 31, 1985, the conversion rate was \$33.64 per share. During 1985 and 1984, debentures with a face value of \$504,000 and \$68,000 were converted into 15,588 shares and 2,290 shares of common stock, respectively. The convertible debentures are unsecured and are subordinate to the rights of depositors and other creditors. In addition, the debentures rank on a parity with the subordinated capital note presently outstanding except as to the portion of the note which will be repaid before the maturity of the convertible debentures.

**Mortgages Payable and Other Contractual Indebtedness:** These are primarily mortgages on bank premises and other real estate owned, which had a book value of \$2.9 million at December 31, 1985. Interest rates range from 7% to 14½%, and remaining maturities range from 2 to 9 years.

The aggregate maturities for long-term debt are as follows:

(In Thousands)	
1986	\$3,880
1987	297
1988	874
1989	876
1990	217
1991 and subsequent	1,840
<b>Total</b>	<b>\$7,984</b>

## Note 7—Common Stock and Employee Stock Plans

Peoples Bancorporation has an incentive stock option plan and a non-qualified stock grant plan, which provide for stock-based awards to key employees. A maximum of 100,000 shares are authorized to be awarded under these plans.

During 1983, 1984 and 1985, incentive stock options to purchase 20,000, 13,000 and 15,200 shares were awarded at an option price of \$16.00, \$24.25 and \$29.75 per share, respectively. One-quarter of the options awarded become exercisable on each of the second through fifth anniversaries of the date of award, at a price not less than 100% of the fair market value of the stock at the time of award. As of December 31, 1985, options to purchase 48,200 shares were outstanding at prices ranging from \$16.00 to \$29.75 per share, of which 5,000 were exercisable at a price of \$16.00 per share. As of December 31, 1985, no stock options had been exercised.

The non-qualified stock grant plan provides for the granting of rights to receive shares of the corporation's common stock as consideration for the employees' continued employment with and efforts on behalf of the corporation. The stock is to be presented in equal amounts on each of the sixth through tenth anniversaries of the date of award. During 1983 and 1985, grants in the amount of 17,000 and 1,000 shares were awarded, respectively. No grants were awarded in 1984. As of December 31, 1985, grants in the amount of 18,000 shares had been awarded.

The Peoples Bancorporation Long-Term Incentive Plan provides for the granting of stock appreciation rights to key employees. These stock appreciation rights (SARs) are cash awards which vest according to prescribed schedules. The actual value of the SAR is the difference between the base value and the fair market value of the corporation's common stock on the date the SAR is exercised, plus dividends paid on the stock during the period the award was held. The base value is tied to the fair market value of the stock during the quarter preceding that in which the award is made. A total of 75,000 SARs are authorized to be awarded under the program. During 1983 and 1985, 20,000 and 10,000 SARs were awarded, respectively, each with a base value of \$20.625 and \$29.75, respectively. No SARs were awarded in 1984. As of December 31, 1985, 30,000 SARs had been awarded under the plan at base values ranging from \$20.625 to \$29.75. One-quarter of these SARs become exercisable on each of the second through fifth anniversaries of the date of award. At December 31, 1985, 5,000 were exercisable at a base value of \$20.625. As of December 31, 1985, no SARs had been exercised.

Compensation expense recorded in relation to these plans was \$518,065, \$144,369 and \$33,476 in 1985, 1984 and 1983, respectively.

At December 31, 1985, 703,264 shares of common stock were reserved for the conversion of convertible debentures discussed in Note 6. As a result of debenture conversions, the corporation issued 15,588, 2,290 and 749 shares of common stock in 1985, 1984 and 1983, respectively.



## Note 8—Restricted Assets

Certain restrictions exist regarding the ability of the bank to transfer funds to its affiliates, including the parent company. The provisions of the bank's 8¾ % Subordinated Note restrict the bank's dividends declared or paid to not more than 50 % of the annual net income of the prior three years, other than dividends payable in common stock of the bank. In addition, the approval of the Comptroller of the Currency is required to pay dividends which exceed the bank's net profits for that year plus its retained net profits for the preceding two years. Under the most restrictive of these conditions, the bank could have paid additional dividends of \$12,540,000 to the parent company as of December 31, 1985.

Section 23A of the Federal Reserve Act limits the extent to which the bank may make loans or advances to, purchase assets from or invest in the securities of its affiliates. Transactions with any single affiliate cannot exceed 10 % of the bank's capital, surplus and retained earnings (net assets). The total of such transactions with all affiliates may not exceed 20 % of the bank's net assets.

As a result of these restrictions, approximately \$25.1 million of the \$119.4 million of net assets of the bank which were included in consolidated net assets of the corporation were available to be transferred to the parent company at December 31, 1985.

Federal Reserve Board regulations require that the bank maintain certain minimum reserve balances on deposit with the Federal Reserve Bank. The average amounts of such balances for the years ended December 31, 1985 and 1984 were approximately \$19,599,000 and \$22,541,000, respectively.

## Note 9—Employee Benefits

The corporation has a non-contributory pension plan covering substantially all employees of Peoples Bancorporation and its subsidiaries. Total annual pension expense was \$2,263,000 in 1985 and \$1,800,000 in both 1984 and 1983. The corporation makes annual contributions to the plan equal to the amount accrued for pension

expense, including amortization of past service cost over 30 years. The actuarially determined value of benefits and pension fund net assets as of the most recent valuation date of January 1, 1985 were as follows:

(In Thousands)

Actuarial present value of accumulated plan benefits:	
Vested	\$16,249
Non-vested	1,204
<b>Total</b>	<b>\$17,453</b>
Net assets available for benefits	\$22,972

The actuarial assumption of investment earnings rate used in determining pension expense was 7 % and the actuarial assumption of salary escalation was 6 %.

In addition to providing pension benefits, the corporation provides certain health care and life insurance benefits for retired employees. Substantially all of the corporation's employees may become eligible for these benefits if they reach normal retirement age while working for the corporation. The cost of health care benefits for both retirees and active employees is recognized as expense when claims are paid. Life insurance benefits for both retirees and active employees are provided through an insurance company whose premiums are based on the benefits paid during the year. The corporation recognizes the cost of providing such benefits by expensing the annual insurance premiums. For 1985 and 1984, the cost of providing health care and life insurance benefits was \$1,576,000 and \$1,797,000, respectively. The costs for 240 retirees are not separable from the costs for the 2,430 active employees.

The corporation also offers its employees an incentive savings plan. Eligible employees may elect to have from 2 % to 6 % of their base pay deferred and contributed to the plan. The amount deferred is not subject to federal income tax at the time of deferral. The corporation matches 50 % of the employees' contribution. The corporation's expense related to the plan was \$656,000, \$577,000 and \$494,000 in 1985, 1984 and 1983, respectively.

## Note 10—Income Taxes

The components of income tax expense (benefit) for the years ended December 31 were as follows:

(In Thousands)	1985	1984	1983
Currently payable (receivable)	\$ 4,254	\$ 4,081	\$(5,506)
Deferred taxes resulting from:			
Accrual method for reporting purposes and cash method for tax purposes	(1,380)	(666)	1,929
Leasing income recognized on financing method for reporting purposes and on operating method for tax purposes	874	847	649
Provision for credit losses for reporting purposes in excess of that recognized for tax purposes	(1,659)	(2,275)	(139)
Differences in method of recognizing installment loan interest income for reporting purposes and for tax purposes	(281)	(339)	(440)
Pension plan costs recognized for tax purposes and deferred for reporting purposes	71	621	—
Depreciation recognized for tax purposes and deferred for reporting purposes	515	552	258
Investment tax credits recognized for tax purposes and deferred for reporting purposes	159	208	480
Other deferred items	(109)	(14)	42
Deferred income tax expense (benefit)	(1,810)	(1,066)	2,779
<b>Total income tax expense (benefit)</b>	<b>\$ 2,444</b>	<b>\$ 3,015</b>	<b>\$(2,727)</b>
Tax expense (benefit) included above related to security transactions	\$289	\$5	\$(49)



The following is a reconciliation between the statutory federal income tax rate and the effective income tax rate for the years ended December 31:

(In Thousands)	1985		1984		1983	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Income tax at statutory rates	\$7,687	46.0 %	\$8,322	46.0 %	\$1,520	46.0 %
Increase (decrease) resulting from:						
Tax-exempt income	(4,147)	(24.8)	(4,134)	(22.9)	(3,857)	(116.7)
Non-deductible amortization	183	1.1	183	1.0	282	8.5
Investment tax credits	(1,081)	(6.5)	(1,081)	(6.0)	(711)	(21.5)
Capital gains tax rate differential	(245)	(1.5)	(232)	(1.2)	—	—
Other	47	0.3	(43)	(0.2)	39	1.2
<b>Total income tax expense (benefit)</b>	<b>\$2,444</b>	<b>14.6 %</b>	<b>\$3,015</b>	<b>16.7 %</b>	<b>\$(2,727)</b>	<b>(82.5)%</b>

#### Note 11—Commitments and Contingent Liabilities

In the normal course of business there are various commitments outstanding and contingent liabilities such as guaranties and commitments to extend credit which are not reflected in the consolidated financial statements. Management does not anticipate any material losses as a result of these transactions. Included with the various commitments and contingent liabilities are standby letters of credit which at December 31, 1985 and 1984 amounted to \$44,272,000 and \$25,890,000, respectively.

Because of the nature of their activities, the corporation and its subsidiaries are subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the consolidated financial position of the corporation.

#### Note 12—Peoples Bancorporation (Parent Company Only) Financial Information

##### Balance Sheets

December 31 (In Thousands)	1985	1984
<b>Assets</b>		
Cash	\$ 1,539	\$ 914
Equity in net assets of subsidiaries:		
Peoples National Bank of Washington	125,515	115,450
Other subsidiaries	9,450	8,740
<b>Total</b>	<b>134,965</b>	<b>124,190</b>
Loans	11	1,252
Other assets	8,969	9,685
<b>Total Assets</b>	<b>\$145,484</b>	<b>\$136,041</b>
<b>Liabilities and Shareholders' Equity</b>		
Short-term commercial paper	\$ 11	\$ 1,252
Note payable to Peoples National Bank of Washington	4,375	4,504
Other liabilities	1,348	1,396
<b>Total Liabilities</b>	<b>5,734</b>	<b>7,152</b>
Shareholders' equity	139,750	128,889
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$145,484</b>	<b>\$136,041</b>



## Statements of Income

Year Ended December 31 (In Thousands)	1985	1984	1983
<b>Income</b>			
Dividends from subsidiaries:			
Peoples National Bank of Washington	\$ 3,775	\$ 3,152	\$4,641
Other subsidiaries	747	810	1,100
Interest on loans	23	223	1,905
<b>Total Income</b>	<b>4,545</b>	<b>4,185</b>	<b>7,646</b>
<b>Expenses</b>			
Interest (\$439, \$453 and \$464 paid to subsidiary in 1985, 1984 and 1983, respectively)	462	670	2,483
Amortization	355	806	1,132
Other expenses	5	31	80
<b>Total Expenses</b>	<b>822</b>	<b>1,507</b>	<b>3,695</b>
Income before income tax benefit and equity in undistributed net income of subsidiaries	3,723	2,678	3,951
Income tax benefit	184	407	542
Income before equity in undistributed net income of subsidiaries	3,907	3,085	4,493
Equity in undistributed net income of subsidiaries:			
Peoples National Bank of Washington	9,562	11,409	744
Other subsidiaries	798	583	795
<b>Total</b>	<b>10,360</b>	<b>11,992</b>	<b>1,539</b>
<b>Net Income</b>	<b>\$14,267</b>	<b>\$15,077</b>	<b>\$6,032</b>

## Statements of Changes in Financial Position

Year Ended December 31 (In Thousands)	1985	1984	1983
<b>Financial resources were provided by (applied to):</b>			
Operations:			
Net income	\$14,267	\$15,077	\$ 6,032
Non-cash charges (credits):			
Amortization	355	806	1,132
Undistributed net income of subsidiaries	(10,360)	(11,992)	(1,539)
Financial resources provided by operations	4,262	3,891	5,625
Cash dividends paid	(3,772)	(3,775)	(3,789)
Financing activities:			
Short-term commercial paper	(1,241)	(2,944)	(19,975)
Note payable to Peoples National Bank of Washington	(129)	(117)	(200)
Treasury stock acquisitions	(134)	(329)	(555)
Total financing activities	(1,504)	(3,390)	(20,730)
Other activities—(increase) decrease in non-earning assets and liabilities:			
Cash	(625)	266	(993)
Other, net	360	84	(88)
Total other activities	(265)	350	(1,081)
<b>Decrease in financial resources invested in earning assets</b>	<b>\$(1,279)</b>	<b>\$(2,924)</b>	<b>\$(19,975)</b>
<b>Increase (decrease) in earning assets:</b>			
Loans	\$(1,241)	\$(2,944)	\$(19,975)
Investments in subsidiaries	(88)	—	—
Other investments	50	20	—
<b>Decrease in earning assets</b>	<b>\$(1,279)</b>	<b>\$(2,924)</b>	<b>\$(19,975)</b>



**Guarantee of Debt of Subsidiaries:** Peoples Bancorporation has guaranteed the 8<sup>3</sup>/<sub>8</sub> % Series B Subordinated Convertible Debentures issued by Peoples National Bank of Washington. Significant provisions of the debentures are disclosed in Note 6.

**Dividends from Subsidiaries:** Cash dividends of \$4,522,000, \$3,962,000 and \$5,741,000 were declared payable from consolidated subsidiaries to Peoples Bancorporation for the years ended December 31, 1985, 1984 and 1983, respectively. Approximately \$3,577,000, \$3,019,000 and \$4,796,000 of such dividends were received by Peoples Bancorporation as of December 31, 1985, 1984 and 1983, respectively, with the remainder recorded as an accrued receivable.

**Note Payable to Peoples National Bank of Washington:** This note bears interest at 10% per annum. Interest and principal payments totaling \$579,000 are due on February 1 of each year through the year 2000. Principal due is as follows:

(In Thousands)	
1986	\$ 142
1987	156
1988	171
1989	189
1990	207
1991 and subsequent	3,510
<b>Total</b>	<b>\$4,375</b>

Peoples Bancorporation and Subsidiaries

**Report of Ernst & Whinney, Independent Auditors**

Board of Directors  
Peoples Bancorporation  
Seattle, Washington

We have examined the consolidated balance sheets of Peoples Bancorporation and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of income, changes in shareholders' equity, and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Peoples Bancorporation and subsidiaries at December 31, 1985 and 1984, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Seattle, Washington  
January 21, 1986

*Ernst & Whinney*



## Board of Directors

**Joshua Green, Jr.\***  
Honorary Chairman of the Board

**Joshua Green III**  
Chairman of the Board and Chief Executive Officer

**M. Lamont Bean**  
Chairman of the Board  
Pay 'n Save Corporation

**John M. Bloxom, Jr.**  
President and Chief Executive Officer  
Mt. Adams Orchards Corporation

**Charles P. Burnett III**  
Investor

**J.G. Cairns, Jr.**  
President

**Sidney D. Campbell**  
Retired Chairman of the Board  
Foss Launch and Tug Company  
An Affiliate of Dillingham Corporation

**Garrett Eddy**  
Chairman of the Board  
The Port Blakely Mill Company

**John M. Fluke, Jr.**  
Chairman of the Board and Chief Executive Officer  
John Fluke Mfg. Co., Inc.

**E.P. Garrett**  
President  
Welco Lumber Company  
Chairman of the Board  
Merrill and Ring, Inc.

**William Golding**  
Chief Executive Officer  
Forest Grove Industries

**Isabelle S. Lamb**  
President  
Enterprises International, Inc.

**Thomas H. Macbride\*\***  
Attorney at Law

**Harry H. Masto\*\***  
Retired

**Robert G. Perry\*\***  
Retired

**Ward L. Sax**  
Attorney at Law  
Sax and MacIver

**James B. Scroggs**  
Retired

**John E. Steiner**  
Aerospace Consultant  
Retired Vice President  
Corporate Product Development  
The Boeing Company

**E.C. Underhill\*\***  
Retired

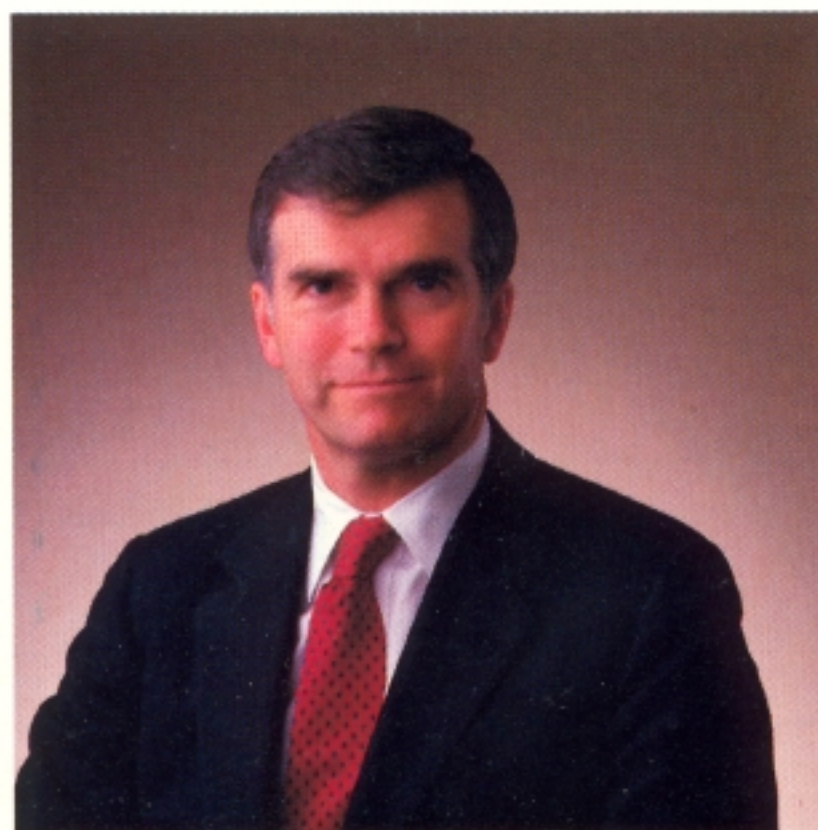
**Corydon Wagner, Jr.**  
Chairman  
R.D. Merrill Company

**Thomas P. Youell**  
President  
The Northwest Company  
Chairman  
Canadian Auto Carriers, Ltd.

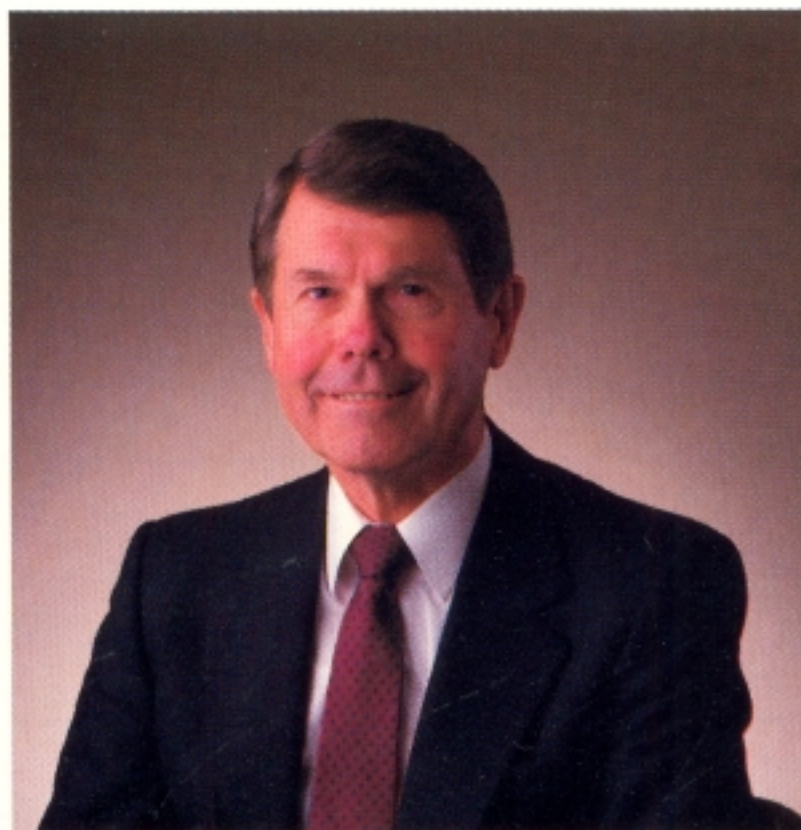
\*Deceased 10-18-85

\*\*Advisory Directors to the Board

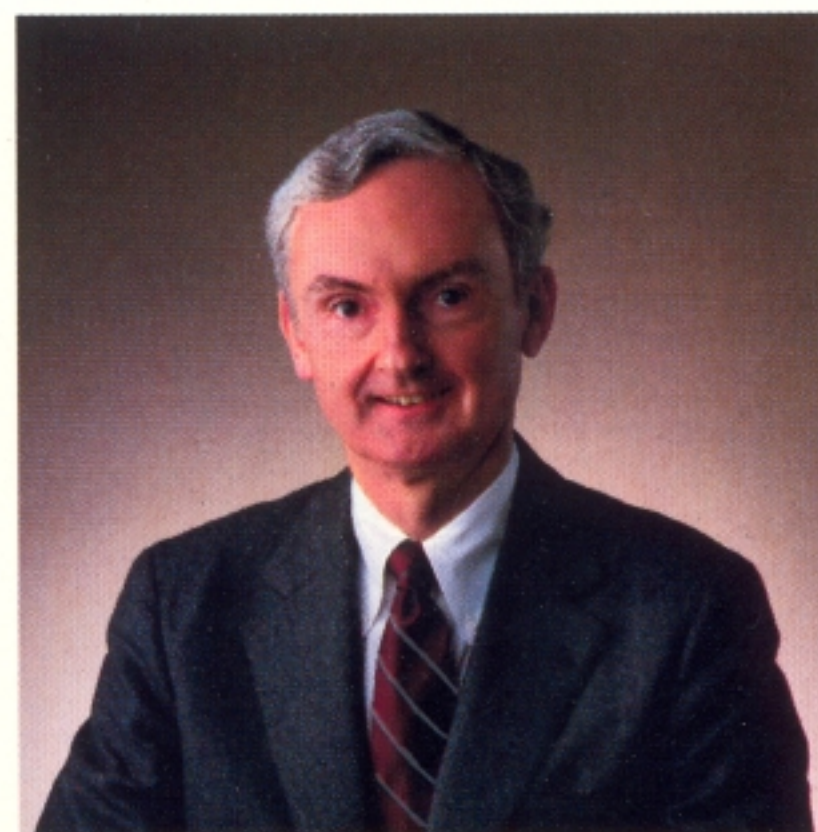
## Administrative Committee



**Joshua Green III**  
Chairman of the Board and Chief Executive Officer



**Elmer M. Anderson**  
Vice Chairman



**Charles E. Riley**  
Executive Vice President



**Leo M. Riley**  
Executive Vice President and Secretary-Treasurer

## General Information

Peoples Bancorporation is a bank holding company organized in Washington state in 1981. Its principal subsidiary is Peoples National Bank of Washington, founded in 1889, which is engaged in a general banking business through its head office in Seattle and 88 other banking offices throughout the state of Washington. Other subsidiaries are engaged in mortgage banking, escrow services and credit life insurance.



## Annual Meeting

The annual meeting of shareholders will be held in the West Room, the Seattle Sheraton, Sixth and Pike, Seattle, Washington, on March 25, 1986 at 3:00 p.m.

## Transfer Agent

Corporate Trust Department  
Peoples National Bank of Washington  
1414 Fourth Avenue  
Seattle, Washington 98111

## Stock Listing

Peoples Bancorporation common stock is traded Over-the-Counter. NASDAQ symbol: PEOP.

## Form 10-K

Copies of Peoples Bancorporation's annual report to the Securities and Exchange Commission, Form 10-K, will be mailed to shareholders upon written request to:

Leo M. Riley  
Executive Vice President and  
Secretary-Treasurer  
1414 Fourth Avenue  
Seattle, Washington 98111

For additional information, write or call:

Peoples Bancorporation  
Post Office Box 720  
1414 Fourth Avenue  
Seattle, Washington 98111  
From Seattle: (206) 344-2300  
From Washington state outside  
of Seattle: 1-800-552-7138  
From outside of Washington state in  
the continental United States:  
1-800-426-0648



# Peoples Bancorporation

1414 Fourth Avenue, Seattle, Washington 98111  
Member FDIC