

COLUMBIA BANKING SYSTEM INC  
Form 10-Q  
May 04, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended March 31, 2007.

**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 0-20288

\_\_\_\_\_  
**COLUMBIA BANKING SYSTEM, INC.**

(Exact name of registrant as specified in its charter)

**Washington**  
(State or other jurisdiction of  
incorporation or organization)  
  
**1301 A Street**  
  
**Tacoma, Washington**  
(Address of principal executive offices)

**91-1422237**  
(I.R.S. Employer  
Identification Number)

**98402-2156**  
(Zip Code)  
  
**(253) 305-1900**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes  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 in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of common stock outstanding at April 30, 2007 was 16,160,709.

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**Table of Contents****CONSOLIDATED CONDENSED STATEMENTS OF INCOME***Columbia Banking System, Inc.**(Unaudited)*

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(in thousands except per share)</b>	
<b>Interest Income</b>		
Loans	\$ 34,030	\$ 28,644
Taxable securities	4,774	4,958
Tax-exempt securities	1,960	1,427
Dividends on Federal Home Loan Bank Stock	11	
Federal funds sold and deposits with banks	371	40
<b>Total interest income</b>	<b>41,146</b>	<b>35,069</b>
<b>Interest Expense</b>		
Deposits	12,159	8,491
Federal Home Loan Bank advances	3,179	1,768
Long-term obligations	507	459
Other borrowings	598	45
<b>Total interest expense</b>	<b>16,443</b>	<b>10,763</b>
<b>Net Interest Income</b>	<b>24,703</b>	<b>24,306</b>
Provision for loan and lease losses	638	215
<b>Net interest income after provision for loan and lease losses</b>	<b>24,065</b>	<b>24,091</b>
<b>Noninterest Income</b>		
Service charges and other fees	2,959	2,834
Merchant services fees	1,969	2,038
Gain on sale of securities available for sale, net		10
Bank owned life insurance ( BOLI )	426	399
Other	823	692
<b>Total noninterest income</b>	<b>6,177</b>	<b>5,973</b>
<b>Noninterest Expense</b>		
Compensation and employee benefits	11,358	9,669
Occupancy	2,837	2,648
Merchant processing	823	784
Advertising and promotion	547	652
Data processing	567	800
Legal and professional services	823	230
Taxes, licenses and fees	613	596
Other	2,834	2,961
<b>Total noninterest expense</b>	<b>20,402</b>	<b>18,340</b>
<b>Income before income taxes</b>	<b>9,840</b>	<b>11,724</b>
Provision for income taxes	2,557	3,536
<b>Net Income</b>	<b>\$ 7,283</b>	<b>\$ 8,188</b>

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Net Income Per Common Share:			
Basic	\$	0.45	\$ 0.52
Diluted	\$	0.45	\$ 0.51
Dividends paid per common share	\$	0.15	\$ 0.13
Weighted average number of common shares outstanding		16,104	15,860
Weighted average number of diluted common shares outstanding		16,262	16,101

See accompanying notes to unaudited consolidated condensed financial statements.

**Table of Contents****CONSOLIDATED CONDENSED BALANCE SHEETS***Columbia Banking System, Inc.**(Unaudited)*

	March 31, 2007	December 31, 2006
	(in thousands)	
<b>ASSETS</b>		
Cash and due from banks	\$ 65,496	\$ 76,365
Interest-earning deposits with banks	15,804	13,979
Federal funds sold	26,250	14,000
<b>Total cash and cash equivalents</b>	<b>107,550</b>	<b>104,344</b>
Securities available for sale at fair value (amortized cost of \$588,824 and \$598,703, respectively)	587,281	592,858
Securities held to maturity at cost (fair value of \$1,620 and \$1,871, respectively)	1,572	1,822
Federal Home Loan Bank stock at cost	10,453	10,453
Loans held for sale	2,999	933
Loans, net of deferred loan fees of (\$3,285) and (\$2,940), respectively	1,833,852	1,708,962
Less: allowance for loan and lease losses	20,819	20,182
<b>Loans, net</b>	<b>1,813,033</b>	<b>1,688,780</b>
Interest receivable	13,837	12,549
Premises and equipment, net	44,152	44,635
Goodwill	29,723	29,723
Other assets	65,604	67,034
<b>Total Assets</b>	<b>\$ 2,676,204</b>	<b>\$ 2,553,131</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing	\$ 447,052	\$ 432,293
Interest-bearing	1,633,974	1,591,058
<b>Total deposits</b>	<b>2,081,026</b>	<b>2,023,351</b>
Short-term borrowings:		
Federal Home Loan Bank advances	212,700	205,800
Securities sold under agreements to repurchase	70,000	20,000
Other borrowings	344	198
<b>Total short-term borrowings</b>	<b>283,044</b>	<b>225,998</b>
Long-term subordinated debt	22,395	22,378
Other liabilities	28,410	29,057
<b>Total liabilities</b>	<b>2,414,875</b>	<b>2,300,784</b>
Commitments and contingent liabilities		
Shareholders' equity:		
Preferred stock (no par value)		
Authorized, 2 million shares; none outstanding		

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	March 31,	December 31,		
	2007	2006		
Common stock (no par value)				
Authorized shares	63,034	63,034		
Issued and outstanding	16,157	16,060	168,033	166,763
Retained earnings			93,904	89,037
Accumulated other comprehensive loss			(608)	(3,453)
Total shareholders' equity			261,329	252,347
Total Liabilities and Shareholders' Equity			\$ 2,676,204	\$ 2,553,131

See accompanying notes to unaudited consolidated condensed financial statements.

**Table of Contents****CONSOLIDATED CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY***Columbia Banking System, Inc.**(Unaudited)*

	Common stock		Retained Earnings (in thousands)	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
	Number of Shares	Amount				
<b>Balance at January 1, 2006</b>	15,831	\$ 163,065	\$ 66,051	\$ (92)	\$ (2,782)	\$ 226,242
Comprehensive income:						
Net income			8,188			8,188
Other comprehensive loss net of tax:						
Net unrealized investment losses					(2,620)	(2,620)
Total comprehensive income						5,568
Transition adjustment related to adoption of SFAS 123(R)		(92)		92		
Issuance of stock under equity compensation plan	66	920				920
Equity compensation awards	72	195				195
Tax benefit associated with exercise of stock options		275				275
Cash dividends paid on common stock			(2,063)			(2,063)
<b>Balance at March 31, 2006</b>	15,969	\$ 164,363	\$ 72,176	\$	\$ (5,402)	\$ 231,137
<b>Balance at January 1, 2007</b>	16,060	\$ 166,763	\$ 89,037	\$	\$ (3,453)	\$ 252,347
Comprehensive income:						
Net income			7,283			7,283
Other comprehensive income net of tax:						
Net unrealized investment/cash flow hedging instrument gains					2,845	2,845
Total comprehensive income						10,128
Issuance of stock under stock option and other plans	57	891				891
Stock award compensation expense	40	194				194
Stock option compensation expense		44				44
Tax benefit associated with exercise of stock options		141				141
Cash dividends paid on common stock			(2,416)			(2,416)
<b>Balance at March 31, 2007</b>	16,157	\$ 168,033	\$ 93,904	\$	\$ (608)	\$ 261,329

See accompanying notes to unaudited consolidated condensed financial statements.



**Table of Contents****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS***Columbia Banking System, Inc.**(Unaudited)*

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(in thousands)</b>	
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 7,283	\$ 8,188
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan and lease losses	638	215
Deferred income tax benefit	(237)	(138)
Excess tax benefit from stock-based compensation	(41)	(49)
Stock-based compensation expense	238	195
Depreciation, amortization & accretion	1,542	1,402
Net realized gains (losses) on sale of assets	2	(136)
Decrease (increase) in loans held for sale	(2,066)	113
Increase in interest receivable	(1,288)	(318)
Increase in interest payable	515	414
Net changes in other assets and liabilities	(838)	(6,031)
Net cash provided by operating activities	5,748	3,855
<b>Cash Flows From Investing Activities</b>		
Purchase of securities available for sale	(800)	(96,743)
Proceeds from sales of securities available for sale		3,865
Proceeds from principal repayments and maturities of securities available for sale	10,316	38,637
Proceeds from maturities of securities held to maturity	250	38,637
Loans originated and acquired, net of principal collected	(124,961)	(30,269)
Purchases of premises and equipment	(772)	(1,098)
Proceeds from disposal of premises and equipment	188	22
Net cash used in investing activities	(115,779)	(85,586)
<b>Cash Flows From Financing Activities</b>		
Net increase (decrease) in deposits	57,675	(12,900)
Proceeds from Federal Home Loan Bank advances	825,945	512,385
Repayment of Federal Home Loan Bank advances	(819,045)	(417,935)
Net increase in repurchase agreement borrowings	50,000	
Net increase (decrease) in other borrowings	146	(2,500)
Cash dividends paid on common stock	(2,416)	(2,063)
Proceeds from issuance of common stock, net	891	920
Excess tax benefit from stock-based compensation	41	49
Other, net		(24)
Net cash provided by financing activities	113,237	77,932
(Decrease) increase in cash and cash equivalents	3,206	(3,799)
Cash and cash equivalents at beginning of period	104,344	100,406
Cash and cash equivalents at end of period	\$ 107,550	\$ 96,607

**Supplemental information:**

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Cash paid for interest	\$ 15,155	\$ 10,439
Cash paid for income taxes	\$ 880	\$ 1,250

See accompanying notes to unaudited consolidated condensed financial statements.

**Table of Contents****NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

*Columbia Banking System, Inc.*

***1. Basis of Presentation and Significant Accounting Policies******(a) Basis of Presentation***

The interim unaudited consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for condensed interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain financial information and footnotes have been omitted or condensed. The consolidated condensed financial statements include the accounts of the Company, and its wholly owned banking subsidiaries Columbia Bank and Bank of Astoria ( Astoria ). All intercompany transactions and accounts have been eliminated in consolidation. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of the results for the interim periods presented have been included. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of results to be anticipated for the year ending December 31, 2007. The accompanying interim unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes contained in the Company's 2006 Annual Report on Form 10-K.

***(b) Significant Accounting Policies***

The significant accounting policies used in preparation of our consolidated financial statements are disclosed in our 2006 Annual Report on Form 10-K. There have not been any other material changes in our significant accounting policies compared to those contained in our 2006 10-K disclosure for the year ended December 31, 2006.

***2. Recent Developments***

*Acquisition of Mountain Bank Holding Company:* On March 28, 2007, the Company announced the signing of a definitive merger agreement with Mountain Bank Holding Company, the parent company of Mt. Rainier National Bank, Enumclaw, Washington, in a cash-and-stock transaction valued at approximately \$60 million (including value to option holders). According to the terms of the definitive agreement Mountain Bank Holding Company shareholders will receive \$25.00 per share in a unit of stock and cash within certain parameters described in the merger agreement. The acquisition, which has been approved by the Boards of Directors of both companies, is subject to, among other contingencies, approval by regulators and Mountain Bank Holding Company shareholders. Mt. Rainier National Bank was formed in 1990 to serve the banking needs of the Enumclaw community. Since then, Mt. Rainier has expanded into several adjacent King County communities and into two markets in Pierce County. As of December 31, 2006, Mountain Bank had approximately \$229.9 million in total assets, \$164.6 million in net loans, \$204.3 million in deposits and \$22.3 million in shareholders' equity. Upon closing of the transaction, which is anticipated to take place in the third quarter of 2007, Mt. Rainier National Bank will be merged into Columbia State Bank and will do business as Mt. Rainier Bank.

*Acquisition of Town Center Bancorp:* On March 28, 2007, the Company announced the signing of a definitive merger agreement with Town Center Bancorp, the parent company of Town Center Bank, Portland, Oregon, in a cash-and-stock transaction valued at approximately \$45.1 million (including value to option holders). According to the terms of the definitive agreement Town Center Bancorp shareholders will receive \$9.382 in cash and 0.3391 of Columbia Banking System shares for each share of Town Center Bancorp common stock. The actual value of the consideration paid for each share of Town Center Bancorp stock will depend on the stock price of the Company at the time of closing. The acquisition, which has been approved by the Boards of Directors of both companies, is subject to, among other contingencies, approval by regulators and Town Center Bancorp shareholders. Founded in 1997, Town Center Bank offers banking services to individuals, professionals and small business clients throughout the Portland Metropolitan area. As of December 31, 2006, Town Center Bancorp had consolidated total assets of approximately \$133.4 million, net loans of \$106.6 million, total deposits of \$103.2 million and stockholders' equity of \$12.9 million. Upon closing of the transaction, which is anticipated to take place in the third quarter 2007, Town Center Bank will be merged into Columbia State Bank.

*Adoption of FIN 48:* Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes, an Interpretation of FASB Statement No. 109* ( FIN 48 ). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. As of March 31, 2007 and January 1, 2007, we had no unrecognized tax benefits. Our policy is to recognize interest and penalties on unrecognized tax

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benefits in Provision for income taxes in the Consolidated Statements of Income. There were no amounts related to interest and penalties recognized for the three months ended March 31, 2007. The tax years subject to examination by federal taxing authorities are the years ending December 31, 2006, 2005, 2004 and 2003. The tax years subject to examination by state taxing authorities are the years ending December 31, 2006, 2005, 2004, 2003 and 2002.

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At March 31, 2007, the Company had one equity compensation plan (the Plan), which is shareholder approved, that provides for the granting of share options and shares to eligible employees and directors up to 2,191,482 shares. Share option and share awards are made at the discretion of the Board of Directors.

*Share Awards:* Restricted share awards provide for the immediate issuance of shares of Company common stock to the recipient, with such shares held in escrow until certain service conditions are met, generally five years of continual service. Recipients of restricted shares do not pay any cash consideration to the Company for the shares, have the right to vote all shares subject to such grant, and receive all dividends with respect to such shares, whether or not the shares have vested. The fair value of share awards is equal to the fair market value of the Company's common stock on the date of grant.

A summary of the status of the Company's nonvested shares as of March 31, 2007 is presented below:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2007	83,175	\$ 32.58
Granted	43,550	33.77
Vested	(500)	34.69
Forfeited	(3,000)	33.10
Nonvested at March 31, 2007	123,225	\$ 32.98

The weighted average grant date fair value of share awards granted during the three months ended March 31, 2006 was \$32.84. As of March 31, 2007, there was \$3.2 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted average period of 3.9 years. The total fair value of shares vested during the three months ended March 31, 2007 was \$17,000; no shares vested during the same period in 2006.

*Share Options:* Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant; those option awards generally vest based on three years of continual service and are exercisable for a five-year period after vesting. Option awards granted have a 10-year maximum term.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The fair value of all options is amortized on a straight-line basis over the requisite service periods, which are generally the vesting periods. The expected life of options granted represents the period of time that they are expected to be outstanding. The expected life is determined based on historical experience with similar awards, giving consideration to the contractual terms and vesting schedules. Expected volatilities of our common stock are estimated at the date of grant based on the historical volatility of the stock. The volatility factor is based on historical stock prices over the most recent period commensurate with the estimated expected life of the award. The risk-free interest rate is based on the U.S. Treasury curve in effect at the time of the award. The expected dividend yield is based on dividend trends and the market value of the Company's stock price at the time of the award.

A summary of option activity under the Plan for the three months ended March 31, 2007 is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
				(\$000)

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Balance at January 1, 2007	335,397	\$	15.76		
Granted					
Forfeited	(1,000)		23.29		
Exercised	(48,617)		12.48		
Balance at March 31, 2007	285,780	\$	16.29	4.0	\$ 4,656
Total Exercisable at March 31, 2007	216,205	\$	13.59	3.4	\$ 2,938

There were no stock options granted by the Company during the three months ended March 31, 2007 and 2006. The total intrinsic value of options exercised during the three months ended March 31, 2007 and 2006 was \$1.1 million for each period.

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As of March 31, 2007, outstanding stock options consist of the following:

Ranges of Exercise Prices		Number of Option Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price of Option Shares	Number of Exercisable Option Shares	Weighted-Average Exercise Price of Exercisable Option Shares
\$7.73	10.29	18,269	1.5	\$ 9.82	18,269	\$ 9.82
10.30	12.87	108,313	2.6	11.44	108,313	11.44
12.88	15.44	42,376	4.6	14.11	42,376	14.11
15.45	18.02	7,350	4.5	17.25	7,350	17.25
18.03	20.59	26,193	6.9	18.63	26,193	18.63
20.60	23.17	20,279	2.5	22.12	13,704	22.37
23.18	25.75	63,000	5.7	25.02		
		285,780	4.0 years	\$ 16.29	216,205	\$ 13.59

It is the Company's policy to issue new shares for share option exercises and share awards. The Company expenses awards of share options and shares on a straight-line basis over the related vesting term of the award. For the three months ended March 31, 2007 and 2006, the Company recognized pre-tax compensation expense related to share options and shares of \$238,000 and \$195,000, respectively.

**4. Earnings per share**

The following table sets forth the computation of basic and diluted net income per share for the three months ended March 31, 2007 and 2006 (in thousands, except for per share data):

	For The Three Months Ended 3/31/2007	For The Three Months Ended 3/31/2006
<i>(dollars in thousands, except per share)</i>		
Net income	\$ 7,283	\$ 8,188
Weighted average common shares outstanding (for basic calculation)	16,104	15,860
Dilutive effect of outstanding common stock options	158	241
Weighted average common stock and common equivalent shares outstanding (for diluted calculation)	16,262	16,101
Net earnings per common share - basic	\$ 0.45	\$ 0.52
Net earnings per common share - diluted	\$ 0.45	\$ 0.51

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the three month periods ended March 31, 2007 and March 31, 2006 there were no anti-dilutive shares outstanding related to options to acquire common stock.

**5. Dividends**

On January 25, 2007, the Company declared a quarterly cash dividend of \$0.15 per share, payable on February 22, 2007 to shareholders of record as of the close of business on February 7, 2007. Subsequent to quarter end, on April 25, 2007, the Company declared a quarterly cash dividend of \$0.17 per share, payable on May 23, 2007, to shareholders of record at the close of business May 9, 2007. The payment of cash dividends is subject to Federal regulatory requirements for capital levels and other restrictions. In addition, the cash dividends paid by Columbia

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Bank and Bank of Astoria to the Company are subject to both Federal and State regulatory requirements.

### ***6. Business Segment Information***

The Company is managed along two major lines of business within the Columbia Bank banking subsidiary: commercial banking and retail banking. The treasury function of the Company, included in the Other category, although not considered a line of business, is responsible for the management of investments and interest rate risk. The Bank of Astoria banking subsidiary operates as a stand-alone segment of the Company.

The Company generates segment results that include balances directly attributable to business line activities. The financial results of each segment are derived from the Company's general ledger system. Overhead, including sales and back office support functions and other indirect expenses are not allocated to the major lines of business. Since the Company is not specifically organized around lines of business, most reportable segments comprise more than one operating activity.



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The principal activities conducted by commercial banking are the origination of commercial business loans, private banking services and real estate lending. Retail banking includes all deposit products, with their related fee income, and all consumer loan products as well as commercial loan products offered in the Company's branch offices.

The organizational structure of the Company and its business line financial results are not necessarily comparable with information from other financial institutions. Financial highlights by lines of business are as follows:

**Condensed Statements of Income:**

<i>(in thousands)</i>	<b>Three Months Ended March 31, 2007</b>				
	<b>Columbia Bank</b>				
	<b>Bank of Astoria</b>	<b>Commercial Banking</b>	<b>Retail Banking</b>	<b>Other</b>	<b>Total</b>
Net interest income after provision for loan and lease loss	\$ 2,123	\$ 6,455	\$ 16,653	\$ (1,166)	\$ 24,065
Other income	381	635	1,490	3,671	6,177
Other expense	(1,434)	(2,804)	(4,762)	(11,402)	(20,402)
Contribution to overhead and profit	1,070	4,286	13,381	(8,897)	9,840
Income taxes					(2,557)
Net income					\$ 7,283
Total assets	\$ 221,559	\$ 1,342,496	\$ 431,067	\$ 681,082	\$ 2,676,204

<i>(in thousands)</i>	<b>Three Months Ended March 31, 2006</b>				
	<b>Columbia Bank</b>				
	<b>Bank of Astoria</b>	<b>Commercial Banking</b>	<b>Retail Banking</b>	<b>Other</b>	<b>Total</b>
Net interest income after provision for loan and lease loss	\$ 2,068	\$ 5,739	\$ 17,280	\$ (996)	\$ 24,091
Other income	368	484	1,540	3,581	5,973
Other expense	(1,394)	(2,577)	(4,487)	(9,882)	(18,340)
Contribution to overhead and profit	1,042	3,646	14,333	(7,297)	11,724
Income taxes					(3,536)
Net income					\$ 8,188
Total assets	\$ 212,130	\$ 1,094,287	\$ 460,891	\$ 693,145	\$ 2,460,453

**7. Securities**

The following table presents the composition and carrying value of the Company's available for sale investment portfolio:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(in thousands)</b>	
<b>Securities Available for Sale</b>		
U.S. Government agency	\$ 72,717	\$ 75,452

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U.S. Government agency mortgage-backed securities and collateralized mortgage obligations	321,251	325,096
State and municipal securities	190,159	189,958
Other securities	3,154	2,352
Total		\$ 587,281