

**FEDERAL DEPOSIT INSURANCE CORPORATION**

550 17<sup>th</sup> Street, N.W. Washington, D.C. 20429

**FORM 10-QSB**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTER ENDED SEPTEMBER 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_ TO \_\_\_\_

**FDIC Certificate Number: 20164**

**SUNWEST BANK**

(Exact name of small business issuer as specified in its charter)

**CALIFORNIA**

(State or other jurisdiction of  
Incorporation or organization)

**95-2630202**

(IRS Employer  
Identification No.)

**17542 East 17<sup>th</sup> Street Ste 200 Tustin, California**

(Address of principal executive offices)

**92780-1960**

(Zip Code)

**(714) 730-4400**

(Issuer's telephone number)

**N/A**

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

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

Number of shares outstanding of each of the issuer's classes of common equity as of October 24, 2006: 17,263

Transitional Small Business Disclosure Format. Yes  No

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION - UNAUDITED  
(Dollars in thousands)

	September 30, 2006	December 31, 2005
<b>ASSETS</b>		
Cash and due from banks .....	\$ 16,469	\$ 12,867
Fed funds sold, mutual funds and interest bearing deposits .....	62,205	64,877
Total cash and cash equivalents .....	78,674	77,744
Securities, available for sale ("AFS"), at fair value .....	57,258	58,229
Loans, net of deferred fees .....	150,361	158,336
Allowance for loan losses .....	(2,351)	(2,351)
Net loans.....	148,010	155,985
Investment in Federal Home Loan Bank ("FHLB") stock .....	1,090	1,384
Premises and equipment, net .....	1,122	1,080
Bank-owned life insurance.....	8,721	-
Other assets .....	1,782	2,081
Total Assets .....	<u>\$ 296,657</u>	<u>\$ 296,503</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Liabilities:		
Demand deposits .....	\$ 161,790	\$ 165,000
Money market and savings accounts .....	78,272	76,238
Time deposits .....	12,944	13,695
Total deposits .....	253,006	254,933
FHLB advances .....	5,375	5,375
Accounts payable and other liabilities .....	3,403	3,350
Total Liabilities .....	261,784	263,658
Commitments and contingencies.....	-	-
Shareholder's Equity		
Preferred stock, no par value: 5,000,000 shares authorized, no shares issued and outstanding at September 30, 2006 or December 31, 2005 .....	-	-
Common stock, no par value: 30,000,000 shares authorized, 17,263 and 17,221 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively .....	27,599	27,159
Retained earnings since November 30, 2002 .....	7,037	5,696
Accumulated other comprehensive income, net of tax.....	237	(10)
Total Shareholders' Equity .....	34,873	32,845
Total Liabilities and Shareholders' Equity .....	<u>\$ 296,657</u>	<u>\$ 296,503</u>

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF INCOME  
 (Dollars in thousands, except per share amounts)

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest income				
Loans.....	\$ 3,212	\$ 3,109	\$ 9,446	\$ 9,417
Securities, AFS and trading.....	729	628	2,003	1,948
Fed funds sold and mutual funds.....	1,027	520	2,973	948
Total interest income.....	<u>4,968</u>	<u>4,257</u>	<u>14,422</u>	<u>12,313</u>
Interest expense				
Deposits.....	437	232	1,062	641
Borrowings.....	61	61	179	179
Total interest expense.....	<u>498</u>	<u>293</u>	<u>1,241</u>	<u>820</u>
Net interest income.....	4,470	3,964	13,181	11,493
Provision for loan losses.....	-	-	-	98
Net interest income after provision for loan losses.....	<u>4,470</u>	<u>3,964</u>	<u>13,181</u>	<u>11,395</u>
Noninterest income:				
Deposit charges.....	120	120	390	358
Net gain (loss) from sales of securities and trading activities.....	-	-	(398)	121
Other income.....	61	37	117	115
Total noninterest income.....	<u>181</u>	<u>157</u>	<u>109</u>	<u>594</u>
Noninterest expense:				
Compensation and benefits.....	1,535	1,398	4,759	4,218
Occupancy and depreciation.....	555	498	1,663	1,508
Customer service.....	996	612	2,867	1,600
Professional services.....	180	218	508	764
Other expenses.....	464	586	1,461	1,664
Total noninterest expense.....	<u>3,730</u>	<u>3,312</u>	<u>11,258</u>	<u>9,754</u>
Income before taxes.....	921	809	2,032	2,235
Income taxes.....	291	302	691	804
Net income.....	<u>\$ 630</u>	<u>\$ 507</u>	<u>\$ 1,341</u>	<u>\$ 1,431</u>
Net income per share:				
Basic.....	\$ 36.56	\$ 29.48	\$ 77.86	\$ 83.22
Diluted.....	\$ 36.37	\$ 29.40	\$ 77.42	\$ 83.05
Shares used to compute:				
Basic net income per share.....	17,230	17,197	17,224	17,195
Diluted net income per share.....	17,320	17,242	17,320	17,231

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN  
STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME - UNAUDITED  
(Dollars in thousands)

	Common Stock		Retained Earnings	Accumulated Other Comprehensive	Shareholders' Equity
	Shares	Amount		Income (Loss)	
Balance, December 31, 2004 ....	17,187	\$ 27,063	\$ 3,556	\$ 526	\$ 31,145
Net income.....	-	-	1,431	-	1,431
Other comprehensive income, net of tax: unrealized gains and (losses) and recognition of unrealized gains and (losses) on securities AFS.....	-	-	-	(368)	(368)
Common stock issued.....	12	28	-	-	28
Balance September 30, 2005 ....	<u>17,199</u>	<u>\$ 27,091</u>	<u>\$ 4,987</u>	<u>\$ 158</u>	<u>\$ 32,236</u>
Balance, December 31, 2005 ....	17,221	\$ 27,159	\$ 5,696	\$ (10)	\$ 32,845
Net income.....	-	-	1,341	-	1,341
Other comprehensive income, net of tax: unrealized gains and (losses) and recognition of unrealized gains and (losses) on securities AFS.....	-	-	-	247	247
Stock-based compensation expense, and related issuance of stock.....	30	413	-	-	413
Common stock issued.....	12	27	-	-	27
Balance, September 30, 2006 ...	<u>17,263</u>	<u>\$ 27,599</u>	<u>\$ 7,037</u>	<u>\$ 237</u>	<u>\$ 34,873</u>

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED  
(Dollars in thousands)

	For the Nine Months Ended September 30,	
	2006	2005
<b><u>Cash Flows from Operating Activities</u></b>		
Net income .....	\$ 1,341	\$ 1,431
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization .....	347	317
Provision for loan losses and unfunded loan commitments .....	12	98
Income accreted on bank-owned life insurance.....	(21)	-
Deferred income taxes.....	12	(86)
Net loss (gain) on sales of securities and trading activities .....	398	(121)
Amortization and accretion of AFS securities.....	23	182
Dividends of FHLB Stock.....	(49)	(44)
Stock-based compensation expense .....	413	-
Decrease in other assets.....	115	497
Decrease in other liabilities .....	339	503
Net cash provided by operating activities.....	2,930	2,777
<b><u>Cash Flows from Investing Activities</u></b>		
Proceeds from maturities and repayments of securities .....	1,803	5,763
Purchases of AFS securities .....	(15,780)	(16,673)
Proceeds from sale of AFS securities .....	14,946	22,146
Proceeds from sale of Federal Home Loan Bank stock .....	343	110
Purchase of bank-owned life insurance.....	(8,700)	-
Net decrease in loans.....	7,975	9,617
Purchases of premises and equipment.....	(389)	(98)
Net cash provided by investing activities .....	198	20,865
<b><u>Cash Flows from Financing Activities</u></b>		
Decrease in deposits .....	(1,927)	(15,402)
Advances from Federal Reserve Bank .....	-	200
Repayments of advances from Federal Reserve Bank .....	-	(200)
Payments for fractional shares relating to 2004 stock split.....	(298)	(1,853)
Proceeds from exercise of common stock options .....	27	28
Net cash used in financing activities .....	(2,198)	(17,227)
Increase in cash and cash equivalents .....	930	6,415
Cash and cash equivalents at beginning of period.....	77,744	59,247
Cash and cash equivalents at end of period.....	\$ 78,674	\$ 65,662
<b><u>Supplemental disclosures of cash flow information:</u></b>		
Cash paid during the period for:		
Interest .....	\$ 1,173	\$ 737
Income taxes .....	445	621

(See accompanying notes to consolidated financial statements)

SUNWEST BANK AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2006  
(Unaudited)

**Basis of Presentation**

The consolidated financial statements include the accounts of Sunwest Bank and its wholly owned subsidiaries, Sunwest Leasing Corp, North Orange County Bancorp and WCV, Inc. All significant intercompany balances have been eliminated. The results of operations reflect any interim adjustments, all of which are of a normal recurring nature and which, in the opinion of management, are necessary for a fair presentation of the results for the interim period presented. The results for the 2006 interim period are not necessarily indicative of the results expected for the full year.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB and the rules and regulations of the Federal Deposit Insurance Corporation and include all information and footnotes required for interim financial statement presentation. The financial information provided herein, including the information under the heading Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), is written with the presumption that the users of the interim financial statements have read, or have access to, the most recent Annual Report on Form 10-KSB which contains the latest available audited consolidated financial statements and notes thereto, as of December 31, 2005 together with the MD&A as of such date.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain reclassifications have been made to the prior year's consolidated financial statements to conform to the 2006 presentation.

**Earnings Per Share**

The following table provides information used to calculate earnings per share as of the periods indicated (dollars in thousands except per share amounts):

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Net income.....	\$ 630	\$ 507	\$ 1,341	\$ 1,431
Weighted average number of common shares outstanding:				
Basic shares .....	17,230	17,197	17,224	17,195
Dilutive effect of restrictive stock grants .....	64	-	64	-
Dilutive effect of stock options .....	26	45	32	36
Dilutive .....	<u>17,320</u>	<u>17,242</u>	<u>17,320</u>	<u>17,231</u>
Net income per share:				
Basic.....	\$ 36.56	\$ 29.48	\$ 77.86	\$ 83.22
Diluted .....	36.37	29.40	77.42	83.05

The Bank has 729 stock options outstanding at September 30, 2006 that could potentially dilute EPS in future periods that were excluded from the above computations because the impact of including them was antidilutive.

## Recent Accounting Developments

In December 2004, the Financial Accounting Standards Board (FASB), issued SFAS No. 123 (revised 2004), "Share—Based Payment" ("Statement 123R"). This Statement requires that compensation costs related to share-based payment transactions be recognized in the financial statements. Measurement of the cost of employee service will be based on the grant-date fair value of the equity or liability instruments issued. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. Additionally, liability awards will be re-measured each reporting period. Statement 123R replaces SFAS No. 123, "Accounting for Stock-Based Compensation" and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees".

The Bank adopted Statement 123R on January 1, 2006 using the "modified prospective method." Under this method compensation expense is recognized using the fair-value method for all new stock option awards as well as any existing awards that are modified, repurchased or cancelled after January 1, 2006 and prior periods are not restated. In addition, the unvested portion of previously awarded options outstanding as of January 1, 2006 will also be recognized as expense over the requisite service period based on the fair value of those options as previously calculated at the grant date under the pro-forma disclosures of Statement 123R. The fair value of each grant is estimated using the Black-Scholes option pricing model. During the quarter and nine months ended September 30, 2006, the Bank recognized \$0.1 million and \$0.4 million of stock-based compensation expense, respectively, as a result of the adoption of Statement 123-R. As of September 30, 2006, approximately \$0.5 million of unrecognized compensation expense is anticipated to be recognized through April 30, 2011, related to outstanding unvested options. In 2005, the pro-forma impact of expensing stock options was immaterial.

In July 2006, FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"), which clarifies the accounting and disclosure for uncertainty in tax positions, as defined. FIN 48 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. This interpretation is effective for fiscal years beginning after December 15, 2006. The Bank has not yet determined the impact this interpretation will have on our results from operations or financial positions

## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Cautionary Statement Regarding Forward-Looking Statements**

Certain statements in this Report on Form 10-QSB constitute "forward-looking statements" under the Private Securities Litigation Act of 1995, which involve risks and uncertainties. Although we believe that the expectations reflected in our forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors (some of which are beyond our control). These factors include, but are not limited to: the strength of the United States economy in general and the strength of the regional and local economies within California; inflation, interest rate and monetary fluctuations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; the effect of government regulation generally and any supervisory or regulatory orders, specifically; adverse changes in the local real estate market, as our loans are concentrated in California and a majority of these loans have real estate as collateral; geopolitical conditions, including acts or threats of terrorism, actions taken by the United States or other governments in response to acts or threats of terrorism and/or military conflicts which could impact business and economic conditions in the United States and abroad; natural disasters; and the impact of changes in financial services policies, laws and regulations, including laws, regulations and policies concerning taxes, banking, securities and insurance, and the application thereof by regulatory bodies. In addition, factors which may affect our forward-looking statements are set forth in our Annual Report on Form 10-KSB under the heading "Business Considerations and Certain Factors that May Affect Future Results of Operations and Stock Price" and in our other current and periodic filings with the FDIC.

We do not intend, and specifically disclaim any obligation to update our forward-looking information and statements, whether written or oral, to reflect changes. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

### **CRITICAL ACCOUNTING POLICIES**

The following discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, and the notes thereto, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in our consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable in the circumstances; however, actual results may differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods.

Our allowance for loan losses is established through a provision for loan losses charged to expense and may be reduced by a recapture of the allowance, which is also reflected in the statement of income. Loans are charged against the allowance for loan losses when management believes that collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible based on an evaluation of the collectibility of loans and prior loan loss experience. This evaluation also takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans and current economic conditions that may affect the borrower's ability to pay. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic or other conditions.

### **CHANGES IN FINANCIAL CONDITION**

*Overview:* Sunwest Bank's financial condition has not changed significantly over the past few years. We fund our interest earning assets, (loans and investment securities), primarily with low cost deposits. Our only borrowing is a \$5.4 million FHLB advance. We continue to maintain high levels of liquidity as we invest our available funds in short-term investments (federal funds, certificates of deposits and money market mutual funds) or in securities. Since December 31, 2005, our loan portfolio has decreased as payoffs and paydowns have exceeded internally generated loan originations. While deposit balances have decreased slightly since December 31, 2005, our deposit base is growing, as evidenced by the increase in our average deposit balances, as we continue to focus our marketing efforts on core deposit growth. Our capital position is strong as our current regulatory capital levels are well in excess of the minimum levels required to be considered a "well capitalized" institution.

*Cash and cash equivalents and securities:* Between December 31, 2005 and September 30, 2006, cash and cash equivalents increased \$0.9 million. During the first quarter of 2006, we sold \$15.3 million of US Treasury securities with a weighted average yield of 3.77%, resulting in a loss on sale of \$0.4 million. During the second and third quarters, we purchased \$15.7 million of US Treasury and municipal securities with a weighted average yield of 4.98%. Additionally, during the third quarter, we invested in and purchased bank-owned life insurance in the amount of \$8.7 million.

*Loans:* The following table provides a breakdown of our loan portfolio as of the dates indicated (dollars in thousands):

	September 30, 2006	December 31, 2005
Commercial.....	\$ 56,140	\$ 55,396
Real estate – other.....	55,012	57,892
Real estate – construction.....	37,126	40,456
Personal loans.....	2,332	4,893
Total loans.....	<u>150,610</u>	<u>158,637</u>
Allowance for estimated loan losses.....	(2,351)	(2,351)
Deferred loan fees and expenses.....	(249)	(301)
Total loans, net.....	<u>\$ 148,010</u>	<u>\$ 155,985</u>

During the first nine months of 2006, total loans decreased \$8.0 million as a result of \$37.1 million of payoffs and collections of principal, net of advances, on existing loans, offset in part by \$29.1 million of fundings of new loans.

*Deposits:* While deposits as of September 30, 2006 were \$1.9 million lower than December 31, 2005, during the first nine months of 2006 average deposits increased \$9.6 million when compared to the first nine months of 2005. During 2006, as general market rates and deposit rates offered by other financial institutions have increased, we have significantly increased our rates on interest bearing deposit accounts and increased our marketing efforts to retain balances from existing customers, increase deposits from existing customers and attract new customers.

*Borrowings:* As of September 30, 2006, our only borrowing consisted of a \$5.4 million FHLB advance, which matures in June of 2009. While we have the ability to borrow additional funds from the FHLB and other sources, we do not anticipate utilizing any additional borrowings in the near future due to our high level of liquidity.

## RESULTS OF OPERATIONS

### Overview

The following table provides selected financial information related to our results of operations for the periods indicated (dollars in thousands):

	For the Quarter Ended September 30,		For the Nine Months Ended September 30,	
	2006	2005	2006	2005
Income before taxes.....	\$ 921	\$ 809	\$ 2,032	\$ 2,235
Net income.....	630	507	1,341	1,431
Ratio of net income to: (annualized)				
Average shareholders equity.....	7.37 %	6.31 %	5.34 %	6.00 %
Average total assets.....	0.83 %	0.69 %	0.59 %	0.65 %

Our income before taxes for the quarter ended September 30, 2006, increased \$0.1 million compared to the same period in 2005, while income before taxes for the year-to-date period ending September 30 2006 decreased \$0.2 million, compared to the corresponding period in 2005. While our net interest income during the three and nine months ended September 30, 2006 has significantly increased over the corresponding periods in 2005, these increases have been offset by the results on sales of securities, increased compensation and benefits and higher customer service expense due to increases in analysis earnings credited to certain of our business customers.

## Net Interest Income

The following table sets forth, for the periods indicated, information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yields; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rate; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin (dollars in thousands):

	For the Quarter Ended September 30,					
	2006			2005		
	Average Balance	Interest	Average Yield /Cost	Average Balance	Interest	Average Yield /Cost
<b>Interest earning assets:</b>						
Loans .....	\$ 148,014	\$ 3,212	8.53 %	\$ 167,527	\$ 3,109	7.30 %
Securities, AFS .....	56,330	713	5.02	54,181	613	4.49
Fed funds sold / mutual funds ...	81,562	1,027	4.93	60,300	520	3.37
FHLB Stock .....	1,085	16	5.85	1,392	15	4.28
Total interest earning assets .....	286,991	4,968	6.81	283,400	4,257	5.91
Noninterest earning assets .....	15,884			12,254		
Total assets .....	<u>\$ 302,875</u>			<u>\$ 295,654</u>		
<b>Interest bearing liabilities:</b>						
Deposits:						
Interest bearing demand .....	\$ 26,589	33	0.49	\$ 26,949	11	0.16
Money market .....	71,233	268	1.49	72,138	127	0.70
Time and savings .....	18,766	136	2.88	20,117	94	1.85
Total deposits .....	116,588	437	1.49	119,204	232	0.77
Borrowings .....	5,375	61	4.54	5,375	61	4.54
Total interest bearing liabilities .....	121,963	498	1.62	124,579	293	0.93
Noninterest bearing deposits .....	143,045			135,148		
Other noninterest bearing liabilities .....	3,585			3,523		
Shareholders' equity .....	34,282			32,404		
Total liabilities and equity .....	<u>\$ 302,875</u>			<u>\$ 295,654</u>		
Net interest earning assets .....	<u>\$ 165,028</u>			<u>\$ 158,821</u>		
Net interest income / interest rate spread .....		<u>\$ 4,470</u>	<u>5.19 %</u>		<u>\$ 3,964</u>	<u>4.98 %</u>
Net interest margin .....			<u>6.23 %</u>			<u>5.59 %</u>

For the Nine Months Ended September 30,

	2006			2005		
	Average Balance	Interest	Average Yield /Cost	Average Balance	Interest	Average Yield /Cost
<b>Interest earning assets:</b>						
Loans .....	\$ 150,162	\$ 9,446	8.34 %	\$ 173,515	\$ 9,417	7.19 %
Securities, AFS .....	53,657	1,954	4.87	54,025	1,733	4.29
Trading securities.....	-	-	-	6,669	168	3.37
Fed funds sold / mutual funds ...	84,154	2,973	4.66	43,145	948	2.90
FHLB Stock .....	1,212	49	5.41	1,426	47	4.41
Total interest earning assets .....	289,185	14,422	6.61	278,780	12,313	5.86
Noninterest earning assets.....	13,972			13,011		
Total assets.....	<u>\$ 303,157</u>			<u>\$ 291,791</u>		
<b>Interest bearing liabilities:</b>						
Deposits:						
Interest bearing demand.....	\$ 27,384	67	0.33	\$ 27,703	34	0.16
Money market.....	69,502	606	1.17	73,037	390	0.71
Time and savings .....	19,812	389	2.63	18,817	217	1.54
Total deposits .....	116,698	1,062	1.22	119,557	641	0.72
Borrowings .....	5,375	179	4.44	5,378	179	4.44
Total interest bearing liabilities....	122,073	1,241	1.36	124,935	820	0.88
Noninterest bearing deposits .....	143,960			131,449		
Other noninterest bearing liabilities.....	3,386			3,513		
Shareholders' equity .....	33,738			31,894		
Total liabilities and equity.....	<u>\$ 303,157</u>			<u>\$ 291,791</u>		
Net interest earning assets .....	<u>\$ 167,112</u>			<u>\$ 153,845</u>		
Net interest income / interest rate spread .....		<u>\$ 13,181</u>	<u>5.25 %</u>		<u>\$ 11,493</u>	<u>4.98 %</u>
Net interest margin.....			<u>6.09 %</u>			<u>5.51 %</u>

*Interest income:* Our yield on average interest earning assets increased 90 and 75 basis points in the quarter and nine months ended September 30, 2006, respectively compared to corresponding periods in 2005, creating additional interest income of \$0.7 million and \$2.1 million.

The average yield on our loans increased 123 basis points to 8.53% during the third quarter of 2006 from 7.30% in the corresponding period in 2005 while average loans decreased \$19.5 million. During the nine months ended September 30, 2006 the average yield on our loans increased 115 basis points to 8.34% from 7.19% in the corresponding period in 2005 while average loans decreased \$23.3 million. During the third quarter of 2006, the yield on our real estate and commercial loan portfolios increased 129 and 109 basis points, respectively, when compared to the corresponding period in 2005. During the nine months ended September 30, 2006, the yield on our real estate and commercial loan portfolios increased 106 and 130 basis points, respectively, when compared to the corresponding period in 2005. The yield on these primarily adjustable rate loan portfolios has increased as a result of the increases in short term interest rates in the overall market over the last 21 months. The decrease in average loans in both the three and nine month periods is due primarily to decreases in both our real estate loan portfolio and commercial loan portfolio, respectively, as significant payoffs in construction loans and payoffs in our commercial portfolio have been higher than our new originations over the past 21 months.

The yield on fed funds sold and mutual funds increased during the quarter and nine months ended September 30, 2006 as compared to the corresponding periods in 2005, as a result of the increase in short term interest rates in the overall market over the last 21 months. The increase in yield on the primarily fixed rate available for sale securities portfolio for the quarter and nine months ended September 30, 2006 as compared to the corresponding periods in 2005, is due primarily to the sale of lower yielding securities and the purchase of higher yielding securities over the last 21 months. The opportunity to purchase higher yielding securities was the result of the increases in short-term interest rates in the overall market over the last 21 months.

*Interest expense:* Sunwest Bank has a high proportion of noninterest bearing deposit accounts and very limited levels of borrowing which allow us to fund our operations at a relatively low interest cost. At September 30, 2006, the proportion of noninterest bearing deposit balances to total deposits was 63.9% and our borrowings were only 2.5% of our total liabilities. The cost of interest bearing liabilities for the quarter and nine-month periods in 2006 were 1.62% and 1.36%, respectively, compared to 0.93% and 0.88% in the corresponding periods in 2005. For the quarter and nine months ended September 30, 2006 interest expense increased \$0.2 million and \$0.4 million, respectively, when compared to the corresponding periods in 2005 as a result of increases in the cost of interest bearing deposits.

The cost of interest bearing deposits increased to 1.49% and 1.22% for the quarter and nine months ended September 30, 2006, respectively, as compared to 0.77% and 0.72% for the same periods in 2005. The increase in costs is the result of the increases in short-term interest rates in the overall market over the last 21 months. As a result of these increases in interest rates, interest expense on deposits increased to \$0.5 million and \$1.0 million for the quarter and nine months ended September 30, 2006 compared to \$0.2 million and \$0.6 million to the same periods in 2005.

The Bank has an outstanding note in the amount of \$5.4 million due to the Federal Home Loan Bank, which matures in June 2009 and carries a fixed rate of 4.38%.

*Net interest income / net interest margin:* As a result of the increases in short term interest rates in the overall market over the last 21 months and other funding benefits discussed above, our net interest income increased \$0.5 million and \$1.2 million during the third quarter and first nine months of 2006, respectively, compared to the corresponding periods in 2005. Our net interest margin increased to 6.23% and 6.09% for the quarter and nine months ended September 30, 2006, respectively, as compared to 5.59% and 5.51% for the corresponding periods in 2005.

#### Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume); (ii) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (iii) changes in rate/volume (change in rate multiplied by change in volume) for the periods indicated (dollars in thousands):

	For the Quarters Ended September 30, 2006 and 2005			
	Increase (Decrease) Due to			Net Increase (Decrease)
	Rate	Volume	Rate / Volume	
Interest earning assets:				
Loans.....	\$ 518	\$ (356)	\$ (59)	\$ 103
Securities AFS.....	72	24	4	100
Trading securities.....	-	-	-	-
Fed funds sold / mutual funds.....	234	179	94	507
FHLB Stock.....	5	(3)	(1)	1
Change in interest income.....	<u>829</u>	<u>(156)</u>	<u>38</u>	<u>711</u>
Interest bearing liabilities:				
Deposits:				
Interest bearing demand.....	22	-	-	22
Money market.....	143	(2)	-	141
Time and savings.....	51	(6)	(3)	42
Total deposits.....	<u>216</u>	<u>(8)</u>	<u>(3)</u>	<u>205</u>
Borrowings.....	-	-	-	-
Change in interest expense.....	<u>216</u>	<u>(8)</u>	<u>(3)</u>	<u>205</u>
Change in net interest income.....	<u>\$ 613</u>	<u>\$ (148)</u>	<u>\$ 41</u>	<u>\$ 506</u>

	For the Nine Months Ended September 30, 2006 and 2005			
	Increase (Decrease) Due to			Net Increase (Decrease)
	Rate	Volume	Rate / Volume	
<b>Interest earning assets:</b>				
Loans.....	\$ 994	\$ (840)	\$ (125)	\$ 29
Securities AFS.....	157	(8)	72	221
Trading securities.....	-	(168)	-	(168)
Fed funds sold / mutual funds.....	380	594	1,051	2,025
FHLB Stock.....	7	(5)	-	2
Change in interest income.....	<u>1,538</u>	<u>(427)</u>	<u>998</u>	<u>2,109</u>
<b>Interest bearing liabilities:</b>				
Deposits:				
Interest bearing demand.....	23	-	10	33
Money market.....	165	(13)	64	216
Time and savings.....	<u>102</u>	<u>8</u>	<u>62</u>	<u>172</u>
Total deposits.....	290	(5)	136	421
Borrowings.....	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Change in interest expense.....	<u>290</u>	<u>(5)</u>	<u>136</u>	<u>421</u>
Change in net interest income.....	<u>\$ 1,248</u>	<u>\$ (422)</u>	<u>\$ 862</u>	<u>\$ 1,688</u>

### Noninterest Income

The \$0.5 million decrease in noninterest income for the nine months ended September 30, 2006 was the result of differences in gains and losses realized from the sale of investment securities. From time to time, we may decide to sell investments and the resulting gain or loss is recognized at the time of sale. Losses on sales of securities of \$0.4 million were realized during the first nine months of 2006, compared to a net gain on sale of securities and trading activities of \$0.1 million during the same period in 2005.

### Noninterest Expense

Noninterest expense increased \$0.4 million and \$1.5 million for the quarter and nine months ended September 30, 2006 as compared to the corresponding periods in 2005 due primarily to increases in both compensation and benefits and customer service. The increases in compensation and benefits are primarily due to the impact of stock related compensation expenses of \$0.1 million and \$0.4 million for the quarter and nine months ended September 30, 2006. No similar expenses were incurred in the corresponding periods in 2005. Eligible third party costs related to analysis earnings credits and paid on behalf of certain of our business customers are recorded as customer service expenses. Because of higher interest rates, the analysis earnings credits provided to certain of our customers were significantly higher in the quarter and nine months ended September 30, 2006 as compared to the corresponding periods in 2005, resulting in higher customer service costs.

### Income Taxes

Our effective income tax rate for the nine months ended September 30, 2006 was 34.0% as compared to 35.6% for the corresponding period in 2005. During the nine months ended September 30, 2006, interest income from tax-free municipal securities is a larger percentage of income before taxes than for the corresponding period in 2005, resulting in a lower effective tax rate. As a result of the merger of West Coast Bancorp with and into Sunwest Bank in 2001, as of January 1, 2006, Sunwest Bank has \$2.5 million of tax benefits available to offset future taxable income relating to the net operating tax loss carryforward of West Coast Bancorp, subject to annual limitations of \$0.9 million.

## Nonperforming Assets and Provision for Credit Losses

At September 30, 2006 and December 31, 2005, we did not have any loans on nonaccrual status. Total delinquent loans or loans up to 90 days delinquent as to interest or principal totaled \$1.5 million, representing 1.03% of total loans outstanding at September 30, 2006. There were no delinquent loans at December 31, 2005.

The following table summarizes the activity in our allowance for loan losses for the periods indicated (dollars in thousands):

	For the Quarter Ended Sept. 30,		For the Nine Months Ended Sept. 30,	
	2006	2005	2006	2005
Balance: beginning of period.....	\$ 2,351	\$ 2,350	\$ 2,351	\$ 2,218
Provision for credit losses.....	-	-	-	98
Recoveries of amounts previously charged off...	-	-	-	34
Balance: end of period.....	<u>\$ 2,351</u>	<u>\$ 2,350</u>	<u>\$ 2,351</u>	<u>\$ 2,350</u>
Allowance for loan losses as a % of total loans..	1.56%	1.42%	1.56%	1.42%

The allowance for loan losses is derived by analyzing the historical loss experience and asset quality within each loan portfolio segment, along with assessing qualitative environmental factors, and correlating it with the delinquency and classification status for each portfolio segment. We utilize a loan grading system with five classification categories, including assets classified as Pass, based upon credit risk characteristics which categorizes each loan by risk grade allowing for a more consistent review of similar loans. Management has also evaluated the loss exposure of classified loans, which are reviewed individually based on the evaluation of the cash flow, collateral, other sources of repayment, guarantors and any other relevant factors to determine the inherent loss potential in the credit.

Management considers the following qualitative environmental factors in determining the allocated loss factors when analyzing the allowance for loan losses: the levels of and trends in past due, nonaccrual and impaired loans; levels of and trends in charge-offs and recoveries; the trend in volume and terms of loans; the effects of changes in credit concentrations; the effects of changes in risk selection and underwriting standards, and other changes in lending policies, procedures and practices; the experience, ability and depth of management and other relevant staff; national and local economic trends and conditions; and industry conditions.

Management believes that its allowance for loan losses at September 30, 2006 was adequate. Nevertheless, there can be no assurance that additions to such allowance will not be necessary in future periods. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our valuation allowance. These agencies may require increases to the allowance based on their judgments of the information available to them at the time of their examination.

## Liquidity

The objective of liquidity management is to ensure that we have the continuing ability to maintain cash flows that are adequate to fund our operations and meet our debt obligations and other commitments on a timely and cost-effective basis. Our liquidity management is both a daily and long-term function of funds management. Liquid assets are generally invested in short-term investments such as federal funds sold and certificates of deposit. If we require funds beyond our ability to generate them internally, various forms of both short and long-term borrowings provide an additional source of funds.

Liquidity management at Sunwest Bank focuses on its ability to generate sufficient cash to meet the funding needs of current loan demand, deposit withdrawals, principal and interest payments with respect to outstanding borrowings and to pay operating expenses. Sunwest Bank monitors its liquidity in accordance with guidelines established by its Board of Directors and applicable regulatory requirements. Sunwest Bank's need for liquidity is affected by its loan activity, net changes in deposit levels and the scheduled maturities of its borrowings. The principal sources of the Bank's liquidity consist of deposits, loan interest and principal payments and prepayments, FHLB advances and proceeds from the sale of securities.

Sunwest Bank's liquid asset ratio (the sum of cash, investments available-for-sale, excluding pledged amounts, and Federal funds sold, divided by total assets) was 43.35% at September 30, 2006. At September 30, 2006, Sunwest Bank had available borrowing capacity totaling \$94 million. Management believes the Bank has sufficient liquidity to support its operations.

## Capital Resources and Dividends

The following table reflects Sunwest Bank's actual levels of regulatory capital as of September 30, 2006 and the applicable minimum regulatory capital requirements as well as the regulatory capital requirements that apply to be deemed "Well Capitalized" pursuant to the prompt corrective action requirements (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of September 30, 2006</u>						
Tier 1 leverage ratio.....	\$ 34,311	11.34%	\$ 12,115	4.00%	\$ 15,144	5.00%
Tier 1 risk-based capital ratio .	34,311	16.11	8,518	4.00	12,778	6.00
Total risk based capital ratio...	36,854	17.31	17,037	8.00	21,296	10.00
<u>As of December 31, 2005</u>						
Tier 1 leverage ratio.....	\$ 32,189	10.73%	\$ 12,003	4.00%	\$ 15,004	5.00%
Tier 1 risk-based capital ratio .	32,189	15.62	8,242	4.00	12,363	6.00
Total risk based capital ratio...	34,720	16.85	16,484	8.00	20,605	10.00

Sunwest Bank is classified as a "Well Capitalized" depository institution for regulatory purposes.

We have no material commitments for capital expenditures as of September 30, 2006. Sunwest Bank has not paid dividends in 2006 and has no plans to pay dividends.

## Off-Balance Sheet Arrangements

The following table provides the off-balance sheet arrangements of Sunwest Bank as of September 30, 2006 (dollars in thousands):

Commitments to fund loans .....	\$ 60,950
Commitments under letters of credit.....	1,120

Of the commitments to fund loans, \$20.8 million are for construction loans. The remainder relates primarily to revolving lines of credit or other commercial loans, and many of these commitments are expected to expire without being drawn upon. Therefore, the total commitments do not necessarily represent future cash requirements.

## ITEM 3. Controls and Procedures

- (a) Based on their evaluation of Sunwest Bank's disclosure controls and procedures as of the end of the period covered by this report on Form 10-QSB, Sunwest Bank's principal executive officer and principal financial officer have concluded that Sunwest Bank's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of September 30, 2006 are effective.
- (b) There has been no change in Sunwest Bank's internal controls over financial reporting that occurred during the last fiscal quarter that has materially affected or is reasonably likely to materially affect Sunwest Bank's internal controls over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

None

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

### Item 3. Defaults Upon Senior Securities

None

### Item 4. Submission of Matters to a Vote of Security Holders

None

### Item 5. Other Information

None

### Item 6. Exhibits

<u>Number</u>	<u>Description</u>
31.1	Section 302 Certification for Glenn E. Gray
31.2	Section 302 Certification for John Michel
32.1	Section 906 Certification for Glenn E. Gray and John M. Michel

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized,

SUNWEST BANK

Registrant

Date: October 31, 2006

/s/ Glenn E. Gray

Glenn E. Gray, Chief Executive Officer

Date: October 31, 2006

/s/ John Michel

John M. Michel, Chief Financial Officer

## CERTIFICATIONS

I, Glenn E. Gray, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Sunwest Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting;
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of small business issuer's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: October 31, 2006

/s/ Glenn E. Gray  
Glenn E. Gray  
Chief Executive Officer

## CERTIFICATIONS

I, John M. Michel, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Sunwest Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting;
5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of small business issuer's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: October 31, 2006

/s/ John Michel  
John Michel  
Chief Financial Officer

**CEO AND CFO CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Sunwest Bank (the "Company") on Form 10-QSB for the periods ending September 30, 2006 as filed with the Federal Deposit Insurance Corporation (the "Report"), we, Glenn E. Gray, Chief Executive Officer of the Company, and John M. Michel, Chief Financial Officer of the Company, each certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge, based on a review of the Report of the Company, and except as corrected or supplemented in a subsequent report:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

	SUNWEST BANK _____ Registrant
Date: <u>October 31, 2006</u>	<u>/s/ Glenn E. Gray</u> Glenn E. Gray, Chief Executive Officer
Date: <u>October 31, 2006</u>	<u>/s/ John Michel</u> John M. Michel, Chief Financial Officer