

WESTAMERICA BANCORPORATION

Form 424B3

May 07, 2002

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Filed Pursuant to Rule 424(b)(3)

Registration No. 333-86150

**Prospectus of**

**WESTAMERICA BANCORPORATION**  
**1108 Fifth Avenue**  
**San Rafael, CA 94901**

**Proxy Statement of**

**KERMAN STATE**  
**BANK**  
**306 South Madera Avenue**  
**Kerman, California 93630**

This document is being furnished to the shareholders of Kerman State Bank in connection with the solicitation of proxies by the board of directors of Kerman State Bank to be used in voting at a special meeting of shareholders of Kerman State Bank to be held on Thursday, May 30, 2002 at 5:00 p.m. This document is first being mailed to holders of common stock of Kerman State Bank on or about May 1, 2002.

The meeting has been called to consider and vote upon a proposal to approve the Agreement and Plan of Reorganization dated as of February 25, 2002, the related merger agreement and the transactions contemplated by the agreements between Kerman State Bank, Westamerica Bancorporation and Westamerica's wholly owned subsidiary Westamerica Bank, and to act upon such other matters as may properly come before the meeting or any adjournment thereof.

If the merger is completed, Kerman State Bank shareholders will receive approximately 0.2731 shares of Westamerica common stock for each share of Kerman State Bank common stock they hold, subject to certain possible adjustments as described in the merger agreement. Westamerica common stock is traded on the Nasdaq National Market under the symbol WABC. The estimated exchange ratio of 0.2731 is the ratio that would apply if Westamerica's average closing price is \$39.77, which was the average starting price of Westamerica common stock as defined in the merger agreement. On April 25, 2002, Westamerica common stock closed at \$44.39 per share. Based on that closing price, and assuming no adjustments (other than adjustments related to the Westamerica stock price), the exchange ratio would be 0.2569 and you would receive for each share of Kerman State Bank common stock Westamerica common stock with a value of \$11.40. For explanation of the possible adjustments and examples of how adjustments may affect the exchange ratio and per share value, see Conversion of Kerman State Bank Common Stock beginning on page 25. This prospectus covers a maximum of 420,000 shares of Westamerica common stock that may be issued to Kerman State Bank shareholders in the merger. The specific details of the merger agreement are more fully discussed under the heading The merger in this document, and in the merger agreement which is in Appendix A to this document. **You should also review and consider the matters described under the heading Risk factors on page 9 in determining whether to approve the merger.**

The affirmative vote of the holders of a majority of the issued and outstanding shares of Kerman State Bank common stock is required to approve the merger.

**Neither this transaction nor the securities of Westamerica have been approved or disapproved by the Securities and Exchange Commission or any state securities commission nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this document. Any representation to the contrary is a criminal offense.**

You may also want to review the documents listed under Where you can find more information on page 68.

The date of this proxy statement/prospectus is April 26, 2002.

This document incorporates important business and financial information about Westamerica that is not included in or delivered with this document. That information is available from Westamerica without charge, excluding all exhibits unless specifically incorporated by reference in this document, by requesting them in writing or by telephone from Westamerica Bancorporation, Kris Irvine, Assistant Corporate Secretary, 4550 Mangels Boulevard, Fairfield, California 94585, (707) 863-6826. If you would like to request documents from Westamerica, please do so by May 17, 2002, to receive them before the meeting.

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**KERMAN STATE BANK**

**306 South Madera Avenue  
Kerman, California 93630  
(559) 846-5321**

**NOTICE OF SPECIAL MEETING OF SHAREHOLDERS**

Time	5:00 p.m. on Thursday, May 30, 2002
Place	Kerman State Bank 306 South Madera Avenue Kerman, California 93630
Items of business	(1) To approve the Agreement and Plan of Reorganization (the merger agreement ) dated as of February 25, 2002, the related agreement of merger, and the transactions contemplated by the merger agreement among Kerman State Bank, Westamerica Bancorporation and Westamerica Bank; and  (2) To consider such other business as may properly come before the meeting.
Record date	You are entitled to vote if you were a shareholder at the close of business on April 15, 2002.
Voting by proxy	Please submit a proxy by mail as soon as possible so that your shares can be voted at the meeting in accordance with your instructions. For specific instructions, please refer to the Questions and Answers beginning on page 1 of this proxy statement and the instructions on the proxy card.

BY ORDER OF THE BOARD OF DIRECTORS

*Corporate Secretary*

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**QUESTIONS AND ANSWERS ABOUT THE MERGER**

**Q: What will happen to Kerman State Bank in this merger?**

A: Immediately after the merger, Kerman State Bank will merge with Westamerica Bank. The resulting bank will continue under the name Westamerica Bank as a wholly owned subsidiary of Westamerica. The existing branches of Kerman State Bank will become branches of Westamerica Bank.

**Q: How do I vote?**

A: Simply indicate on your proxy card how you want to vote and then sign and mail your proxy card in the enclosed return envelope as soon as possible so that your shares may be represented at the Kerman State Bank special meeting.

**Q: If my shares are held in street name by my broker, will my broker vote my shares for me?**

A: Your broker will not vote your shares for you unless you provide instructions to your broker on how to vote. It is important therefore that you follow the directions provided by your broker regarding how to instruct your broker to vote your shares. If you fail to instruct your broker how to vote your shares, the effect will be the same as a vote against the merger agreement.

**Q: Can I change my vote after I have mailed my signed proxy card?**

A: Yes. You may change your vote at any time before your proxy is voted at the Special Meeting. If your shares are held in your name you may do this in one of three ways. First, you may send a written notice stating that you would like to revoke your proxy. Second, you may complete and submit a new proxy card. If you choose either of these two methods, you must submit your notice of revocation or your new proxy card to Kerman State Bank at the address at the top of the Notice of Special Meeting in time so as to receive it prior to the vote at the special meeting. Third, you may attend the meeting and vote in person if you tell the Secretary that you want to cancel your proxy and vote in person. Simply attending the Kerman State Bank special meeting, however, will not revoke your proxy. If you have instructed a broker to vote your shares, you must follow directions received from your broker to change your vote or to vote at the Kerman State Bank special meeting.

**Q: Should I send in my certificates now?**

A: No. After the merger is completed, we will send you written instructions for exchanging your stock certificates.

**Q: When do you expect this merger to be completed?**

A: We are working toward completing this merger as quickly as possible. We currently expect to complete this merger in mid-2002.

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**SUMMARY**

This summary, together with the Questions and Answers on the preceding pages, highlights important selected information from this proxy statement/prospectus. To understand the merger fully and for a more complete description of the legal terms of the merger, you should read carefully this entire document and the other information available to you. We have included page references in parentheses to direct you to a more complete description of the topics presented in this summary.

**Kerman State Bank shareholders will receive approximately 0.2731 of a share of Westamerica common stock in the merger, but this ratio is subject to adjustment (page 25)**

When the merger is completed, you will receive approximately 0.2731 of a share of Westamerica common stock for each share of Kerman State Bank common stock that you hold, subject to certain possible adjustments. For example, if you hold 100 shares of Kerman State Bank common stock, you will have the right to receive 27.31 shares of Westamerica common stock in the merger (assuming no adjustments). You will receive cash instead of fractional shares. Therefore, you would only receive 27 shares of Westamerica common stock. You would also receive a check in an amount equal to 0.31 of a share multiplied by an average closing price of the Westamerica common stock. The average closing price of the Westamerica common stock will be determined based on the closing prices of the stock on each of the 20 consecutive trading days prior to two business days before the closing date, the date on which the transactions relating to the merger are completed.

The exchange ratio (the number of shares of Westamerica common stock into which each share of Kerman State Bank common stock will be converted at closing) is a function of several factors, including Kerman State Bank's adjusted equity (as defined in the merger agreement), amount of performing loans and Significant Liabilities (as defined in the merger agreement). The exchange ratio may be reduced if:

Kerman State Bank's performing loans before closing are less than \$60 million;

Kerman State Bank's allowance for loan losses before closing, determined under Westamerica's methodology, is greater than \$3.2 million;

Kerman State Bank incurs certain obligations defined as Significant Liabilities, which include new unapproved leases and other contractual obligations; capital expenditures above \$25,000; contingent liabilities related to hazardous materials; new or accelerated severance or pension obligations; merger-related expenses above \$470,000; and certain loan loss provisions and write-downs of foreclosed property; or

The average closing price for Westamerica common stock over the 20 trading days ending two business days before the closing is greater than \$41.76.

The exchange ratio may be increased if:

Kerman State Bank's allowance for loan losses before closing, determined under Westamerica's methodology, is less than \$2.4 million; or

Westamerica's average closing price is less than \$33.80.

The adjustments that will be made on account of the forgoing factors are interrelated and are described in Section 2.1(a) of the merger agreement.

**Comparative market price data**

Westamerica common stock is quoted on Nasdaq. Kerman State Bank common stock is thinly traded in the over-the-counter market, is quoted in the Electronic Bulletin Board and is not quoted on Nasdaq.

The following table presents historical per share market values for Westamerica common stock and Kerman State Bank common stock and the equivalent pro forma market values (i) on February 22, 2002, the last trading day prior to public announcement of the merger and (ii) on April 25, 2002. The historical values



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represent the last sale prices on or before the dates indicated. The values shown for Westamerica may be higher or lower than the average closing price of Westamerica common stock as that term is defined in the merger agreement. The equivalent pro forma market value per share of Kerman State Bank common stock reflects an exchange ratio of 0.2731 on February 22 and 0.2569 on April 25, 2002 and assumes an average closing price equivalent to the market prices for Westamerica common stock shown in the table.

	Historical Market Price(1)		Kerman State Bank Equivalent Pro Forma
	Westamerica	Kerman State Bank	Market Value
February 22, 2002	\$40.69	\$ 5.65	\$ 11.11
April 25, 2002	\$44.39	\$ 10.75	\$ 11.40

(1) The historical market price for Kerman State Bank common stock is based on information provided to management by various sources, but not verified by Kerman State Bank. Kerman State Bank has not been a party to any trades reflected in that information.

Westamerica cannot assure you that the price of its stock will be the same or greater than the prices shown in the table at the time of the merger, or at any time after the completion of the merger. Once Kerman State Bank is acquired by Westamerica, there will be no further public market for Kerman State Bank's common stock. Westamerica common stock will continue to be traded on Nasdaq.

**The merger is intended to be a tax-free transaction in which Kerman State Bank shareholders will not recognize gain or loss (page 21)**

The merger is intended to be a tax-free reorganization so that no gain or loss will be recognized by either Westamerica or Kerman State Bank or their respective shareholders for federal income tax purposes, except for the cash that Kerman State Bank shareholders will receive instead of fractional shares or cash received by Kerman State Bank shareholders who perfect their dissenters' rights.

**Financial advisor gives opinion that consideration is fair to Kerman State Bank shareholders (page 14)**

In deciding to approve the merger, the Kerman State Bank board of directors considered the opinion of its financial advisor, James H. Avery Company, dated as of February 5, 2002, about the fairness of the merger to Kerman State Bank shareholders from a financial point of view. This opinion is attached as Appendix B to this proxy statement/prospectus. We encourage you to read it carefully. Under an agreement with Kerman State Bank, James H. Avery Company will receive a fee of approximately \$237,000, subject to adjustment depending on the actual value of the merger consideration as of closing, when the merger closes.

**Kerman State Bank's board recommends shareholder approval (page 13)**

Kerman State Bank's board of directors believes that the merger is in the best interests of Kerman State Bank and its shareholders and has unanimously approved the merger agreement. Kerman State Bank's board recommends that you vote FOR approval of the merger agreement.

**Shareholders of Westamerica and Kerman State Bank have different rights (page 65)**

The rights of holders of Westamerica common stock are different in some respects from the rights of holders of Kerman State Bank common stock. You should consider these differences when voting on the merger.

**Dissenters' rights of appraisal (page 22 and Appendix C)**

Instead of receiving Westamerica stock, you may be entitled to cash equal to the fair value of your Kerman State Bank shares before announcement of the merger if you perfect your dissenters' rights.



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**Benefits to certain officers and directors in the merger (page 20)**

In considering the recommendation of the board of directors of Kerman State Bank to approve the merger agreement, you should be aware that certain officers and directors of Kerman State Bank have certain interests in, and will receive benefits as a consequence of, the merger that are different from the benefits to Kerman State Bank shareholders generally. These interests include:

Certain officers and directors of Kerman State Bank will receive fully vested options to acquire Westamerica common stock in place of existing vested and unvested options to acquire Kerman State Bank common stock;

Certain officers of Kerman State Bank will be eligible to receive severance payments of up to twelve months salary and, in certain instances, bonuses if Westamerica does not make an offer to retain them as employees in comparable positions or if such officers are terminated during the twelve month period following the merger.

**Information regarding Westamerica and Kerman State Bank (pages 33 and 42)**

Westamerica Bancorporation

4550 Mangels Boulevard  
Fairfield, CA 94585-1200  
(415) 257-8000  
www.westamerica.com

Westamerica Bancorporation is a bank holding company registered under the Bank Holding Company Act of 1956. Westamerica Bancorporation was incorporated under the laws of the State of California as Independent Bankshares Corporation on February 11, 1972. It is the parent of Westamerica Bank and Community Banker Services Corporation. Westamerica has 90 branches throughout northern and central California. Westamerica is the 13th largest bank and 19th largest depository institution, measured by deposits, in California. At December 31, 2001, it had total assets of \$3.9 billion, deposits of approximately \$3.2 billion and shareholders equity of \$314 million.

Kerman State Bank

306 South Madera Avenue  
Kerman, CA 93630  
(559) 846-5321

Kerman State Bank is a state banking corporation licensed as a commercial bank by the California Department of Financial Institutions (DFI). It was originally incorporated in 1983. It is headquartered in Kerman, Fresno County, California. Kerman State Bank conducts a general commercial banking business through its main office and two branches in Firebaugh and Easton, California. At December 31, 2001, Kerman State Bank had assets of approximately \$106 million, deposits of approximately \$93 million and shareholders equity of approximately \$12 million.

**Special shareholders meeting to be held on May 30, 2002 (page 10)**

We will hold the special meeting of shareholders at 5:00 p.m. on Thursday, May 30, 2002, at Kerman State Bank, 306 South Madera Avenue, Kerman, California 93630. At the special meeting, you will be asked (1) to approve the merger agreement and (2) to consider such other business as may properly come before the meeting.

**Record date set at April 15, 2002; vote required for approval of merger (page 11)**

You can vote at the special meeting if you owned Kerman State Bank common stock at the close of business on April 15, 2002. Holders of a majority of the outstanding shares of Kerman State Bank common stock must vote to approve the merger agreement in order for the merger to occur.





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**Conditions that must be satisfied for the merger to occur (page 30)**

We will not complete the merger unless a number of conditions are met. These include:

approval of the merger agreement by Kerman State Bank shareholders,

receipt of all required regulatory approvals,

absence of material adverse changes in the parties, and

absence of any orders suspending the effectiveness of the registration statement filed by Westamerica to register the shares to be issued to Kerman State Bank shareholders.

**Regulatory approvals we must obtain for the merger to occur (page 19)**

The merger requires the prior approval of the Board of Governors of the Federal Reserve System (the FRB ) and the DFI.

**Westamerica to use purchase accounting treatment (page 21)**

Westamerica will account for the merger as a purchase. Under the purchase accounting method, Westamerica will revalue on its books the assets and liabilities of Kerman State Bank at their fair market values, and the amount by which the aggregate merger consideration exceeds the net fair values of the assets of Kerman State Bank will be recorded as intangible assets called goodwill or core deposit intangible.

**Termination of the merger agreement (page 32)**

The merger agreement may be terminated before completion as follows:

by the mutual consent of Kerman State Bank and Westamerica;

by either party if the conditions to its obligations have not been fulfilled;

by either party if the other fails to comply with its obligations under the merger agreement;

by Westamerica if someone other than Westamerica enters into a transaction for the acquisition of Kerman State Bank;

by Westamerica if its board of directors determines that it is not advisable to consummate the merger by reason of any material legal impediment; or

by Kerman State Bank if Westamerica enters into a transaction with someone providing for the acquisition of Westamerica which does not provide for the assumption of the merger agreement.

If Westamerica terminates the merger agreement as a result of Kerman State Bank's failure to obtain a fairness opinion or shareholder approval, or due to Kerman State Bank's breach of the merger agreement, then Kerman State Bank must pay Westamerica a fee of \$250,000.

If Kerman State Bank terminates the merger agreement as a result of its failure to obtain a fairness opinion, then Kerman State Bank must pay Westamerica a fee of \$250,000. If Kerman State Bank terminates this Agreement due to a breach of the merger agreement by Westamerica Bancorporation or Westamerica, then Westamerica shall pay Kerman State Bank a fee of \$250,000.

If Kerman State Bank enters into or solicits a competing transaction, Westamerica may terminate the merger agreement and Kerman State Bank will be liable for a break-up fee of \$1,500,000. If Westamerica enters into a competing transaction that precludes Westamerica from completing the merger, Kerman State Bank may terminate the merger agreement and Westamerica will be liable for a break-up fee of

\$1,000,000.

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The following table presents selected supplemental historical financial information for Westamerica for each of the five years in the period ended December 31, 2001. This information has been derived from and should be read in conjunction with the supplemental consolidated financial statements of Westamerica including the notes to such financial statements, which are incorporated by reference elsewhere in this document.

	Year Ended December 31,				
	2001	2000	1999	1998	1997
	(Unaudited)				
	(Dollars in thousands, except per share data)				
Interest income	\$ 257,056	\$ 269,516	\$ 257,656	\$ 266,820	\$ 270,670
Interest expense	68,887	88,614	78,456	86,665	88,054
Net interest income	188,169	180,902	179,200	180,155	182,616
Provision for loan losses	3,600	3,675	4,780	5,180	7,645
Non-interest income	42,655	41,130	40,174	37,805	37,013
Non-interest expense	102,651	100,198	100,133	101,408	137,878
Income before income taxes	124,573	118,159	114,461	111,372	74,106
Provision for income taxes	40,294	38,380	38,373	37,976	25,990
Net income	\$ 84,279	\$ 79,779	\$ 76,088	\$ 73,396	\$ 48,116
Earnings per share:					
Basic	\$ 2.39	\$ 2.19	\$ 1.97	\$ 1.76	\$ 1.12
Diluted	2.36	2.16	1.94	1.73	1.10
Per share:					
Dividends paid	\$ 0.82	\$ 0.74	\$ 0.66	\$ 0.52	\$ 0.36
Book value at December 31	9.19	9.32	8.10	9.25	9.51
Average common shares outstanding	35,213	36,410	38,588	41,797	43,040
Average diluted common shares outstanding	35,748	36,936	39,194	42,524	43,827
Shares outstanding at December 31	34,220	36,251	37,125	39,828	42,799
<b>At December 31</b>					
Loans, net	\$2,432,371	\$2,429,880	\$2,269,272	\$2,246,593	\$2,211,307
Total assets	3,927,967	4,031,381	3,893,187	3,844,298	3,848,444
Total deposits	3,234,635	3,236,744	3,065,344	3,189,005	3,078,501
Short-term borrowed funds	311,911	386,942	462,345	203,671	264,848
Debt financing and notes payable	27,821	31,036	41,500	47,500	52,500
Shareholders equity	314,359	337,747	300,592	368,596	407,152
<b>Financial Ratios:</b>					
For the year:					
Return on assets	2.18%	2.06%	1.99%	1.94%	1.28%
Return on equity	27.17%	25.78%	23.31%	19.48%	12.71%
Net interest margin(1)	5.71%	5.48%	5.46%	5.52%	5.63%
Net loan losses to average loans	0.15%	0.17%	0.20%	0.20%	0.35%
Efficiency ratio(2)	41.67%	42.45%	43.19%	44.25%	60.15%
At December 31:					
Equity to assets	8.00%	8.38%	7.72%	9.59%	10.58%
Total capital to risk-adjusted assets	10.63%	11.61%	11.75%	13.79%	14.76%
Loan loss reserve to loans	2.10%	2.11%	2.22%	2.23%	2.24%

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- (1) Fully taxable equivalent
  - (2) The ratio of non-interest expenses to the sum of net interest income (FTE) and non-interest income.
- 6
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**Table of Contents****Selected Financial Information about Kerman State Bank**

This financial information for Kerman State Bank for the years 1997 to 2001 is only a summary. You should read it with the audited financial statements and the accompanying notes of Kerman State Bank. Kerman State Bank's financial statements as of December 31, 2001 and 2000, and for the two years in the period ended December 31, 2001 are included in this document.

	Year Ended December 31,				
	2001	2000	1999	1998	1997
<b>Unaudited</b>					
<b>(Dollars in thousands except per share date)</b>					
<b>Results of Operations</b>					
Interest income	\$ 7,495	\$ 9,573	\$ 7,742	\$ 8,138	\$ 7,469
Interest expense	2,690	4,429	3,127	3,241	2,936
Net interest income	4,805	5,144	4,615	4,897	4,533
Provision for loan losses	295	590	570	185	15
Noninterest income	998	934	860	821	611
Noninterest expense	4,005	3,968	3,559	3,469	2,969
Income before income taxes	1,503	1,519	1,346	2,064	2,160
Provision for income taxes	522	530	427	770	824
Net income	981	989	919	1,294	1,336
Basic earnings per share	\$ 0.69	\$ 0.68	\$ 0.63	\$ 0.87(1)	\$ 0.91(1)
Number of shares used in basic earnings per share calculation	1,430,026	1,460,918	1,455,966	1,480,859(1)	1,474,685(1)
Diluted earnings per share	\$ 0.69	\$ 0.68	\$ 0.63	\$ 0.87(1)	\$ 0.90(1)
Number of shares used in diluted earnings per share calculation	1,432,226	1,460,918	1,455,966	1,484,536(1)	1,481,414(1)
<b>Balance sheet (end of period)</b>					
Total assets	\$ 105,328	\$ 113,789	\$ 106,344	\$ 103,010	\$ 107,576
Net loans	62,916	75,646	64,445	62,303	57,469
Deposits	92,877	101,575	95,739	92,492	96,677
Shareholders' equity	11,752	10,911	9,908	9,992	10,121
<b>Financial ratios</b>					
Tier 1 risk-based capital	15.13%	11.81%	10.75%	13.00%	14.51%
Total risk-based capital	16.39%	13.06%	12.32%	14.11%	15.45%
Leverage ratio	11.24%	9.22%	9.37%	9.85%	11.63%
Allowance for loan losses/ period end loans	2.02%	1.64%	2.15%	1.33%	1.16%
Return on average assets	0.93%	0.86%	0.89%	1.29%	1.48%
Return on average equity	8.86%	9.12%	9.61%	12.94%	13.46%
Nonperforming assets to total assets	4.78%	2.58%	3.33%	2.45%	0.66%

(1) Amounts have been restated to reflect 1999 stock dividend

**Table of Contents****Comparative per common share data**

We have summarized the historical per share information for Westamerica and Kerman State Bank and additional information as if the companies had been combined for the period shown ( pro forma ) calculated based on an exchange ratio of 0.2731 of a share of Westamerica common stock per share of Kerman State Bank common stock.

You should read this information with Westamerica's historical financial statements and related notes contained in the Annual Reports on Form 10-K that we have filed with the Securities and Exchange Commission. See [Where You Can Find Additional Information](#) on page 68.

Kerman State Bank equivalent pro forma share amounts are calculated by multiplying the pro forma book value per share and net income per share and Westamerica's historical per share dividends by the exchange ratio so that the per share amounts equate to the respective values for one share of Kerman State Bank common stock. You should not rely on the pro forma information as being indicative of the historical results that we would have had or the future results that will occur after the merger. The equivalent pro forma data reflects the purchase method of accounting and does not reflect potential cost savings or revenue enhancements that may be achieved.

	As of and for the Year Ended December 31, 2001			
	Westamerica		Kerman State Bank	
	Historical	Pro Forma Combined	Historical	Equivalent Pro Forma
Book value	\$9.19	\$9.55	\$8.23	\$2.64
Cash dividends	0.82	0.82	0.00	0.22
Net income (basic)	2.39	2.39	0.69	0.65
Net income (diluted)	2.36	2.36	0.69	0.64

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**RISK FACTORS**

In addition to the other information included in this document, you should consider the matters described below carefully in determining whether to approve the merger agreement. Where we and our is used in this section, it is meant to refer to both Westamerica and Westamerica Bank before the merger and to Westamerica and Westamerica Bank following its proposed acquisition of Kerman State Bank.

*The value of the merger consideration fluctuates based on Westamerica's stock price and the financial performance of Kerman State Bank in specified areas.* The exchange ratio is based on the average price per share of Westamerica's common stock for the 20 consecutive trading days prior to the three trading days before the day the merger is consummated. This average price may vary from the price of Westamerica common stock on the date the merger was announced, on the date that this document is mailed to Kerman State Bank shareholders, and on the date of the special meeting of Kerman State Bank shareholders. Any change in the price of Westamerica common stock prior to completion of the merger may affect the value of the merger consideration that you will receive upon completion of the merger. Stock price changes may result from a variety of factors, many of which are beyond our control. In addition, the exchange ratio will be affected by Kerman State Bank's level of performing loans, the level of its allowance for loan losses, the occurrence of any significant liabilities (generally, expenses above certain thresholds expenses that were unplanned or not approved in advance by Westamerica), as well as by Westamerica's stock price.

*There are uncertainties in integrating our business operations and realizing enhanced earnings.* If we are unable to integrate our businesses successfully, this could hurt our business. The merger involves the integration of companies that have previously operated independently. No assurance can be given that Westamerica and Kerman State Bank will be able to integrate their operations without encountering difficulties including, without limitation, the loss of key employees and customers, the disruption of their respective ongoing businesses or possible inconsistencies in standards, controls, procedures and policies.

*Further economic slowdown in California could hurt our business.* Westamerica has focused its business in Northern and Central California. Kerman State Bank is located solely in Fresno County, and its business is dependent to a significant extent on the agricultural economy. These areas have experienced economic difficulties in the recent past, and a further economic slowdown in California could have the following consequences:

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Demand for our products and services may decline; and

Collateral for loans made by us, especially real estate, may decline in value and in turn reduce our customers' borrowing power.

**INFORMATION REGARDING FORWARD-LOOKING STATEMENTS**

This proxy statement/ prospectus contains certain forward-looking statements with respect to the financial condition, results of operations and business of Westamerica and Kerman State Bank in the future. These forward-looking statements include, but are not limited to statements relating to the cost savings which we expect to realize from the merger, the expected impact of the merger on Westamerica's financial performance, earnings estimates for the combined company, the market value of Westamerica common stock in the future and other statements identified by words such as expects, anticipates, intends, plans, believes, seeks, estimates or words of similar meaning. (see The Merger Reasons for the Merger; Recommendations of the board of directors ). These forward-looking statements are based upon the current beliefs and expectations of Westamerica and Kerman State Bank management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control.

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Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities:

expected cost savings from the merger cannot be fully realized;

deposit attrition, customer loss or revenue loss following the merger is greater than expected;

competitive pressure in the banking industry increases significantly;

operational risks including data processing system failures or fraud;

costs or difficulties related to the integration of the business of Westamerica and Kerman State Bank are greater than expected;

changes in the interest rate environment reduce margins;

general economic conditions, either nationally or regionally, are less favorable than expected, resulting in, among other things, a deterioration in credit quality;

increased economic uncertainty resulting from recent terrorist attacks and the threat of similar attacks in the future;

changes in the regulatory environment;

changes in business conditions and inflation; and

changes in the securities markets.

The forward-looking earnings estimates included in this document have not been examined or compiled by the independent public accountants of Westamerica or Kerman State Bank nor have such accountants applied any procedures to those estimates. Accordingly, such accountants do not express an opinion or any other form of assurance on them. Further information on other factors which could affect the financial results of Westamerica after the merger is included in the SEC filings incorporated by reference into this document.

**SPECIAL MEETING OF KERMAN STATE BANK SHAREHOLDERS**

**Date, time and place of meeting**

The special meeting of shareholders of Kerman State Bank will be held on May 30, 2002, at 5:00 p.m. local time at Kerman State Bank, 306 South Madera Avenue, Kerman, California 93630.

**The meeting**

At the meeting, the shareholders of Kerman State Bank will be asked to consider and vote on the merger agreement dated February 25, 2002 among Westamerica Bancorporation, Westamerica Bank and Kerman State Bank. The merger agreement is included as Appendix A to this proxy statement/ prospectus and is incorporated in this proxy statement/ prospectus by reference. Under the merger agreement:

Kerman State Bank will merge with Westamerica Bank; and

each share of Kerman State Bank common stock would be converted into the right to receive 0.2731 shares of common stock of Westamerica, subject to adjustment depending on such factors as Kerman State Bank's significant liabilities (described on page 2 and 25), allowance for loan losses, performing loans and equity as of the closing date and subject to decrease if Westamerica's average closing stock price before closing is above \$41.76 or increase if Westamerica's average closing price before closing is below \$33.80.

**The board of directors of recommends a vote for the merger**



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In addition to the proposal to approve the merger agreement, at the special meeting you will be asked to act upon such other matters as may properly come before the meeting, including a motion to adjourn.

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### **Record date and voting rights**

Only holders of record of Kerman State Bank common stock at the close of business on April 15, 2002 are entitled to notice of and to vote at the meeting. At the record date, there were approximately 470 shareholders of record and 1,427,507 shares of Kerman State Bank common stock outstanding and entitled to vote. Directors and executive officers of Kerman State Bank and their affiliates owned beneficially as of the record date an aggregate of 297,328 shares of Kerman State Bank common stock (excluding exercisable stock options), or approximately 20.8% of the outstanding Kerman State Bank common stock.

Each shareholder is entitled to one vote for each share of common stock he or she owns.

### **Vote required**

Approval of the merger by Kerman State Bank shareholders requires the affirmative vote of the holders of a majority of the outstanding shares.

### **Voting by proxy**

Shareholders of Kerman State Bank may use the enclosed proxy if they are unable to attend the meeting in person or wish to have their shares voted by proxy even if they attend the meeting. All proxies that are properly executed and returned, unless revoked, will be voted at the meeting in accordance with the instructions indicated or, if no instruction is indicated, in favor of the merger. The execution of a proxy will not affect the right of a shareholder to attend the meeting and vote in person.

### **Revocability of proxies**

A person who has given a proxy may revoke it any time before it is exercised at the meeting by filing with the Secretary of Kerman State Bank, a written notice of revocation or a proxy bearing a later date or by attendance at the meeting and voting in person. Attendance at the meeting will not, by itself, revoke a proxy.

### **Adjournments**

The meeting may be adjourned, even if a quorum is not present, by the vote of the holders of a majority of the shares represented at the meeting in person or by proxy. In the absence of a quorum at the meeting, no other business may be transacted at the meeting.

Notice of the adjournment of a meeting need not be given if the time and place thereof are announced at the meeting at which the adjournment is taken, provided that if the adjournment is for more than 45 days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder of record entitled to vote at the meeting. At an adjourned meeting, any business may be transacted which might have been transacted at the original meeting.

### **Solicitation of proxies**

The proxy relating to the meeting is being solicited by the board of directors of Kerman State Bank. Kerman State Bank will bear the cost of printing and distributing the proxy statement/ prospectus. Copies of solicitation material will be furnished to brokerage houses, fiduciaries and custodians holding in their names shares of Kerman State Bank common stock beneficially owned by others to forward to such beneficial owners. Kerman State Bank may reimburse such persons representing beneficial owners of its shares for their expenses in forwarding solicitation material to beneficial owners. Solicitation of proxies by mail may be supplemented by telephone, telegram or personal solicitation by directors, officers or other regular employees of Kerman State Bank, who will not receive any additional compensation for such efforts.

**Other matters**

The board of Kerman State Bank is not aware of any matters to come before the special meeting other than the approval of the merger agreement. If any other matters should be brought before the special meeting,

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or any adjournment thereof, upon which a vote properly may be taken, the proxy holders will vote in their discretion unless otherwise provided in the proxies. If the merger is completed, Kerman State Bank will not hold an annual meeting of shareholders in 2002.

**PROPOSAL ONE THE MERGER**

**General**

The board of directors of Kerman State Bank has approved the merger agreement, which provides for the merger of Kerman State Bank with and into Westamerica Bank. This section of the proxy statement/prospectus describes some aspects of the merger, including the background of the merger and Kerman State Bank's reasons for the merger.

**Background of the merger**

Kerman State Bank, based in Fresno County, California, has conducted general banking operations to serve individuals and small to medium-sized businesses since 1983. In serving individuals and small businesses, Kerman State Bank historically has focused on a community-based approach to banking.

In April, 2001, the board of directors of Kerman State Bank engaged the services of James H. Avery Company as its financial advisor in connection with potential merger or acquisition transactions. James H. Avery Company contacted numerous potential acquirers. Of these institutions three expressed moderate interest. One, Westamerica, initiated serious discussion while the other two did not.

In May, 2001, preliminary discussions were held with Westamerica about a possible transaction. Upon Westamerica's execution of a confidentiality agreement, Westamerica conducted a tentative off-site review of Kerman State Bank. The parties then discontinued discussions.

They reinitiated discussions in July. On July 10, 2001, Westamerica submitted a non-binding offer to acquire Kerman State Bank. James H. Avery Company reviewed the merits of the proposal and the Kerman State Bank's board of directors determined that a combination with Westamerica might be in the best interest of Kerman State Bank and its shareholders. The board of directors of Kerman State Bank accepted the non-binding offer on July 17, 2001, and Westamerica completed an initial due diligence examination of Kerman State Bank during August, 2001. Westamerica and Kerman State Bank then commenced negotiation of a definitive agreement.

On December 18, 2001, the board of directors of Kerman State Bank met to consider the results of its tentative evaluation of Westamerica and the preliminary draft of a definitive merger agreement. Kerman State Bank's board of directors determined to move forward with the negotiations of a final merger agreement, including the pricing mechanism.

During January, 2002, an additional financial institution contacted Kerman State Bank to express an interest in acquiring Kerman State Bank. Kerman State Bank met with this institution, which presented a tentative maximum purchase price. Details of the offer were submitted to James H. Avery Company for review and comparison to the ongoing Westamerica offer. Results of that analysis indicated that the Westamerica offer had the potential for greater shareholder value, and the Kerman State Bank board of directors elected to continue forward with the Westamerica negotiations.

Negotiations with Westamerica continued, with the board of directors of Kerman State Bank meeting on January 15, 2002 and again on January 30, 2002. At the January 30, 2002 meeting, legal counsel reviewed the salient points of the Westamerica merger agreement and James H. Avery, of James H. Avery Company, reviewed with the board of directors of Kerman State Bank the merits of the proposal, the valuation of the offered stock and the risks involved in the transaction. James H. Avery Company orally issued its opinion that the terms of the Westamerica offer were fair to the shareholders of Kerman State Bank from a financial point of view and later confirmed its opinion in writing. Based on the analysis presented, Kerman State Bank's board of directors perceived the transaction to be within the range of fair prices based on recent similar bank

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transactions and accordingly approved the merger agreement, subject to satisfactory completion of due diligence.

In February, the parties continued to negotiate the details of the agreement and addressed personnel, staffing, severance and other issues as they arose and Kerman State Bank conducted a due diligence examination of Westamerica. The parties executed the merger agreement on February 25, 2002 and made a public announcement of the merger agreement.

**Reasons for the merger; recommendation of Kerman State Bank's board of directors**

Westamerica believes that the merger will provide it with an attractive opportunity to expand its operations in Fresno County. Westamerica believes that Kerman State Bank's locations and business mix complement Westamerica's existing presence in Fresno County and will enable it to offer its broad array of products and services to customers of Kerman State Bank. Westamerica will reduce expenses by consolidating its office in Kerman with Kerman State Bank's main office.

In determining to approve the merger agreement and recommend that Kerman State Bank's shareholders approve and authorize the merger agreement, the Kerman State Bank board of directors consulted with Kerman State Bank's senior management, its financial advisor, as well as its legal counsel, and considered the following material factors:

the increased liquidity to be provided to Kerman State Bank's shareholders by receiving shares of Westamerica common stock in exchange for their shares of Kerman State Bank common stock because Westamerica common stock is listed on the Nasdaq, it has more outstanding shares and shareholders, and the shareholders of Kerman State Bank would have the benefit of a more active market for their shares after completion of the acquisition;

the economic conditions and prospects for the markets in which Kerman State Bank operates, and competitive pressures in the financial services industry in general and the banking industry in particular;

the enhancement of Kerman State Bank's competitiveness and its ability to serve its customers, depositors, creditors, other constituents and the communities in which it operates as a result of a business combination with an institution with greater resources, such as Westamerica;

information concerning the business, results of operations, asset quality and financial condition of Kerman State Bank and Westamerica on a stand-alone and combined basis, and the future growth prospects following the merger;

an assessment that, in the current economic environment, expansion through acquisition by another financial institution would be most economically advantageous to Kerman State Bank's shareholders when compared to other alternatives such as de novo branch openings or branch acquisitions;

the terms and conditions of the merger agreement and related agreements;

the beneficial effects on Kerman State Bank's customers;

James H. Avery Company's analysis of the financial condition, results of operations, business, prospects and stock price of Kerman State Bank and comparison of Kerman State Bank to other banks and bank holding companies operating in its industry;

an analysis of the terms of other acquisitions in the banking industry;

the opinion of James H. Avery Company to the effect that, as of the date of the opinion, the merger agreement is fair, from a financial point of view, to the holders of Kerman State Bank common stock; and

the expectation that the acquisition will constitute a tax-free reorganization for federal income tax purposes.

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In addition to the advantages, discussed in the previous paragraph, of a merger with a larger financial institution, the board of directors and management of Kerman State Bank also discussed the various risks of combining with Westamerica, including:

the disadvantages of being part of a larger entity, including the potential for decreased customer service;

the risk that integration of Kerman State Bank and Westamerica will divert the combined entities' management from other activities; and

the possible adverse effect on certain employees of Kerman State Bank.

However, after weighing the advantages and disadvantages of a merger with Westamerica, the Kerman State Bank board of directors determined that the advantages clearly outweighed the disadvantages.

The above discussion of the factors considered by the Kerman State Bank board of directors is not intended to be exhaustive. In view of the variety and nature of the factors considered by the Kerman State Bank board of directors, the Kerman State Bank board of directors did not find it practicable to assign relative weights to the specific factors considered in reaching its decision.

For the reasons stated above, the board of directors of Kerman State Bank unanimously approved the merger agreement and the related transactions, including the merger. The board of directors of Kerman State Bank believes that the merger is fair and in the best interests of Kerman State Bank and its shareholders. The board of directors of Kerman State Bank unanimously recommends that its shareholders vote FOR approval of the merger.

### **Opinion of Kerman State Bank's financial advisor**

Kerman State Bank's board of directors retained James H. Avery Company, pursuant to an engagement letter dated March 5, 2001, to provide financial advisory services for the purposes of analyzing Kerman State Bank's strategic options including the rendering of a fairness opinion from a financial point of view to Kerman State Bank's shareholders in the event of a proposed merger. Kerman State Bank and James H. Avery Company provided this discussion of the review undertaken by James H. Avery Company.

Kerman State Bank retained James H. Avery Company as investment analysts to determine the fairness, from a financial point of view, to the holders of shares of Kerman State Bank common stock of the consideration to be received by Kerman State Bank in the Westamerica/Kerman merger. Pursuant to the merger agreement, each holder of shares of Kerman State Bank common stock will receive from Westamerica, in exchange for his or her shares of Kerman State Bank common stock, shares of Westamerica common stock. The transaction is based on a share value for Kerman State Bank of 1.6 times Kerman State Bank's adjusted equity of \$9,861,000 as defined in the merger agreement and subject to certain adjustments based on Kerman State Bank's level of performing loans, the adequacy of Kerman State Bank's allowance for loan losses and additional significant liabilities (as defined in the merger agreement). The merger agreement states that it is a condition of closing that the aggregate value not be less than \$12,500,000. The share value for Kerman State Bank is to be exchanged based on the determined market value per share of Westamerica common stock for each share of Kerman State Bank common stock subject to certain adjustments as described in the merger agreement.

James H. Avery Company has acted for Kerman State Bank and for the board of directors of Kerman State Bank as financial advisor in this transaction and will receive a fee for its services, including rendering this opinion, equal to 1.50% of the aggregate consideration paid, a significant portion of which is contingent upon the consummation of the merger. James H. Avery Company has previously provided financial advisory services to Kerman State Bank. James H. Avery Company is not a market maker in shares of Kerman State Bank common stock nor do its principals or employees own, directly or indirectly, any shares of Kerman State Bank common stock. Kerman State Bank's board of directors selected James H. Avery Company to act as its financial advisor on the basis of James H. Avery Company's expertise and experience in the banking industry since 1968. James H. Avery Company is an independent financial advisor to the banking industry in California.

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specializing in capital planning, mergers and acquisitions, the valuation of banks and their securities as well as additional related activities.

No limitations were imposed by Kerman State Bank on James H. Avery Company in the investigations made or procedures followed in rendering its opinion. James H. Avery Company issued the Kerman State Bank fairness opinion on the consideration to be received by the shareholders of Kerman State Bank pursuant to the merger agreement as fair, from a financial point of view, to the holders of the shares of Kerman State Bank common stock on February 5, 2002.

In arriving at the Kerman State Bank fairness opinion, James H. Avery Company has reviewed and analyzed, among other things, the following:

the merger agreement;

certain publicly available financial and other data with respect to Kerman State Bank, Westamerica and Westamerica Bank including the consolidated financial statements for recent years and interim periods to December 31, 2001;

certain other publicly available information concerning Kerman State Bank and Westamerica and internal information concerning Kerman State Bank;

publicly available information concerning other banks and bank holding companies, the trading markets for their securities and the nature, terms and circumstances of certain other merger transactions James H. Avery Company believed to be relevant, in whole or in part, to its inquiry; and

evaluations and analysis prepared and presented to the board of directors of Kerman State Bank.

James H. Avery Company has held discussions with senior management of Kerman State Bank concerning Kerman State Bank's past and current operations, financial condition and prospects, as well as the results of regulatory examinations. James H. Avery Company has reviewed with senior management of Kerman State Bank various operating projections for Kerman State Bank as a stand-alone entity, assuming the Westamerica/ Kerman State Bank merger does not occur. Certain pro forma shareholder value comparative projections were derived by James H. Avery Company for Westamerica and for Kerman State Bank as a stand-alone entity based on historical data.

In conducting the review and in arriving at the Kerman State Bank fairness opinion, James H. Avery Company relied upon and assumed the accuracy and completeness of the financial and other information which was provided to James H. Avery Company or was publicly available. James H. Avery Company has not assumed any responsibility for independent verification of this information. James H. Avery Company has relied upon the management of Kerman State Bank for various operating projections and assumed that such projections reflect the best currently available estimates and judgments of Kerman State Bank management. James H. Avery Company has also assumed, without assuming any responsibility for the independent verification of same, that the allowance for loan losses of Westamerica is adequate to cover its loan losses. James H. Avery Company has also assumed, without assuming any responsibility for the independent verification of same, that there are no active, pending or anticipated legal actions; no under or over market leases or owned fixed asset valuations; or any other under or over-evaluated assets or liabilities for either Kerman State Bank or Westamerica that would significantly change the financial condition for either company.

James H. Avery Company has not made or obtained any evaluations or appraisals of the property of Kerman State Bank or Westamerica, nor has James H. Avery Company examined any individual loan credit files. For purposes of its opinion, James H. Avery Company has assumed that the Westamerica/ Kerman State Bank merger will have the tax, accounting and legal effects described in the merger agreement and has assumed the accuracy of the disclosures in the merger agreement. The Kerman State Bank fairness opinion is limited to the fairness, from a financial point of view, to the holders of shares of Kerman State Bank common stock of the aggregate minimum consideration as described in the merger agreement and does not address Kerman State Bank's underlying decision to proceed with the Westamerica/ Kerman State Bank merger.

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James H. Avery Company has considered the financial and other factors, as it has deemed appropriate under the circumstances, including among others the following:

the historical and current financial positions and results of operations of Kerman State Bank and Westamerica, including interest income, interest expense, net interest income, net interest margin, provision for loan losses, noninterest income, noninterest expense, earnings, dividends, internal capital generation, book value, return on assets, return on shareholders' equity, capitalization, intangible assets, the amount and type of nonperforming assets, and loan losses, all as contained in the financial statements of Kerman State Bank and Westamerica;

the assets and liabilities of Kerman State Bank and Westamerica, including loan, investment and mortgage portfolios, deposits, other liabilities, historical and current liability sources and costs and liquidity, and

the nature, terms and conditions regarding other merger transactions involving banks and bank holding companies.

James H. Avery Company has also taken into account its assessment of economic, market and financial conditions generally and specifically to the markets in which Kerman State Bank and Westamerica operate, as well as its experience in other transactions, in bank securities valuation and its knowledge of the banking industry generally. The Kerman State Bank fairness opinion is necessarily based only upon conditions as they exist and can be evaluated on the date of the opinion and the information made available to James H. Avery Company through the date of the opinion.

James H. Avery Company performed financial analysis and peer-group comparisons with Kerman State Bank relating to overall performance, financial condition and market area characteristics. James H. Avery Company analyzed other bank merger and acquisition transactions announced between May 23, 2001 and January 18, 2002 where the seller's assets were between \$50 million and \$150 million. This asset size peer group was deemed comparable to the \$106 million in assets reported by Kerman State Bank at December 31, 2001. In James H. Avery Company's opinion, the rural and agricultural nature of Kerman State Bank's market area and the lack of sufficient recent regional or California transactions in similar markets as Kerman State Bank's justified analysis of peer group banks nationwide. The transactions analyzed and defined in this section of this proxy statement/prospectus as the peer group were: Community Trust Bancorp/ Citizens National Bank and Trust, First Citizens Bancorp/ Independent Community Bancorp, First Community Bancorp/ WHEC Inc. (Capital Bank of North County), Western Sierra Bancorp/ Central California Bank, Mountainbank Financial Corp./ First Western Bank, Umpqua Holdings Corp./ Linn-Benton Bank, Second Bancorp/ Commerce Exchange Corp., NB&T Financial Group/ Sabina Bank, Catawba Valley Bancshares/ First Gaston Bank of North Carolina, First Community Bancorp/ First Charter Bank, N.A., First Federal Capital Corp./ American Community Bankshares, First Banks America Inc./ Charter Pacific Bank, Bank of North Carolina/ Independence Bank (North Carolina), Regions Financial Corp./ Independence Bank (Texas), Pocahontas Bancorp/ Peoples Bank and CVB Financial/ Western Security Bancorp. The analysis of these announced transactions included comparative financial data relating to income, return on assets, return on equity, nonperforming assets, equity to assets, loan loss reserves, purchase price announced as a multiple to book value, purchase price announced as a multiple of the last twelve months of net income, purchase price announced as a multiple of total assets and purchase price announced as a premium for core deposits over book value with core deposits defined as all domestic deposits less accounts of \$100,000 or more. As discussed in this proxy statement/prospectus, Kerman State Bank's various financial ratios do not compare favorably with the peer group median ratios in the areas of nonperforming assets to total assets, loan loss reserves to nonperforming assets, loan loss reserves to noncurrent loans, return on equity and return on assets. While adjusted equity as described below mitigates, in part, the ratios related to nonperforming assets and loan loss reserves, based on the peer group medians to Kerman State Bank's ratios in these and other areas described above, James H. Avery Company's analysis and judgment was that Kerman State Bank's value should be lower than the peer group median values.

At December 31, 2001, Kerman State Bank's total equity was 11.08% of total assets. The range of peer group banks in terms of total equity to total assets was 7.18% to 17.90% with the median at 9.37%. Kerman



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State Bank's adjusted equity, per the Westamerica/ Kerman State Bank merger agreement, was 9.34% of total assets as of December 31, 2001, a ratio more comparable to the peer group. Adjusted equity per the Westamerica/ Kerman State Bank merger agreement was calculated to include certain loan write-downs, additions to loan loss reserves and estimates of Kerman State Bank's costs of the proposed transaction.

At December 31, 2001, Kerman State Bank's nonperforming assets were 4.90% of total assets. The range of peer group banks as to nonperforming assets to total assets was 0.00% to 2.37% with the median at 0.49%. Nonperforming assets represent potential loss to banking institutions. Kerman State Bank's ratio of such assets was outside the range for the peer group and 10.0 times the median.

At December 31, 2001, Kerman State Bank's loan loss reserves represented 25.09% of nonperforming assets, 50.80% of nonperforming loans and 2.02% to total loans. In calculating adjusted equity per the Westamerica/ Kerman State Bank merger agreement, an increase in Kerman State Bank's loan loss reserves was included which would increase these respective ratios to 46.40%, 93.93% and 3.74%. The range of peer group banks as to loan loss reserves to nonperforming assets was 45.26% to 4,586.67% with one bank having no nonperforming loans and with the median at 270.49%. In this comparison, the lowest peer group bank reserve level was 1.8 times Kerman State Bank's reserve and the median was 10.8 times Kerman State Bank's reserve. If Kerman State Bank's reserve were increased as contemplated to reach the agreed amount of adjusted equity, the lowest peer group ratio and median peer group ratio would be 1.0 times and 5.8 times Kerman State Bank's ratio.

The range of peer group banks for loan loss reserves to noncurrent loans was 45.26% to 4,586.67% with one bank having no noncurrent loans and with the median at 286.91%. In this comparison, the lowest peer group bank reserve ratio was 0.9 times Kerman State Bank's and the median was 5.6 times Kerman State Bank's. If Kerman State Bank's reserve were increased as contemplated to reach the agreed amount of adjusted equity, the lowest peer group ratio and median peer group ratio would be 0.5 times and 3.1 times Kerman State Bank's ratio.

The range of peer group banks for loan loss reserves to total loans was 0.91% to 4.91% with the median at 1.33%. In this comparison, the median was 0.7 times Kerman State Bank's. The peer group median was 0.4 times Kerman State Bank's based on the increase in reserves per the Kerman State Bank/ Westamerica adjusted equity agreement.

At December 31, 2001, Kerman State Bank's return on equity was 8.19% for the year, 2001. The range of peer group banks as to last twelve months net income to equity was -33.42% to +15.53% with the median at 10.53%. In this comparison, the median was 1.3 times Kerman State Bank's. Based on adjusted equity per the Kerman State Bank/ Westamerica merger agreement, Kerman State Bank's December 31, 2001 return on equity ratio is 9.33% and the peer group median is 1.1 times Kerman State Bank's.

At December 31, 2001, Kerman State Bank's return on assets was 0.87% for the year, 2001. The range of peer group banks as to last twelve months net income to assets was -3.02% to +1.77% with the median at 0.96%. In this comparison, the peer group median was 1.1 times Kerman State Bank's.

James H. Avery Company's opinion is that the size and growth of a particular market area relates to the value of those banks operating in that market. Kerman State Bank's headquarters city, the City of Kerman, had total FDIC-insured deposits in all FDIC-insured facilities, including Kerman State Bank's, of \$166 million at June 30, 2001 and such deposits had declined by 0.7% from June 30, 2000. The range of peer group banks as to headquarters city total FDIC-insured deposits (including the deposits of respective peer group banks) was \$43 million to \$11.0 billion with the median at \$529 million. In this comparison, the median was 3.2 times Kerman State Bank's.

The range of peer group banks as to headquarters city FDIC-insured deposit growth from June 30, 2000 to June 30, 2001 was -12.03% to +17.68% with the median at +8.13%. Of the twelve peer group banks, two were headquartered in cities that had negative deposit growth and ten were headquartered in cities that had positive deposit growth.

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James H. Avery Company determined that no transaction reviewed was identical to the subject transaction and that, accordingly, any analysis of comparable transactions necessarily involves subjective considerations and judgments concerning differences in financial, operating and market characteristics of the parties to the transactions being compared.

Set forth below is a brief summary of the considerations related to the fairness opinion rendered on February 5, 2002.

*Multiple of Book Value Method.* This valuation approach is formulated on the announced purchase prices and multiples of book values based on the announced transactions of Kerman State Bank's asset-size peer group.

The peer group multiple factor ranged from 1.19 to 2.18 with the median at 1.58. The multiple of book value is but one methodology utilized in the determination of overall market value of Kerman State Bank. Utilizing the Multiple of Book Value Method (based on Kerman State Bank's adjusted book value per the merger agreement) the acquisition value, as of the Kerman State Bank fairness opinion report date, is as follows:

$$\$9,861,000 \text{ (adjusted book value per agreement)} \times 1.58 \text{ (the peer group median)} = \$15,580,000$$

*Multiple of Income Method.* This valuation approach is formulated on the announced purchase prices and multiples of net income over the previous twelve months based on announced transactions of Kerman State Bank's asset-size peer group. Such income data for Kerman State Bank was based on call report data through December 31, 2001.

The peer group multiple factor ranged from 12.64 to 43.57 with the median at 19.81. The multiple of income is but one methodology utilized in the determination of overall market value of Kerman State Bank. Utilizing the Multiple of Income Method (based on Kerman State Bank's twelve-month income through December 31, 2001) the acquisition value, as of the Kerman State Bank fairness opinion report date, is as follows:

$$\$920,000 \text{ (last twelve months income)} \times 19.81 \text{ (the peer group median)} = \$18,225,000$$

*Percentage of Total Assets Method.* This valuation approach is formulated on the announced purchase prices as a percentage of total assets based on the announced transactions of Kerman State Bank's asset-size peer group. Such asset data for Kerman State Bank was based on call report data as of December 31, 2001.

The peer group percentage factor ranged from 10.25% to 24.16% with the median at 15.61%. The percentage of total assets is but one methodology utilized in the determination of overall market value of Kerman State Bank. Utilizing the Percentage of Total Assets Method (based on Kerman State Bank's total assets as of December 31, 2001) the acquisition value, as of the Kerman State Bank fairness opinion report date, is as follows:

$$\$105,535,000 \text{ (as of December 31, 2001)} \times .1561 \text{ (the peer group median)} = \$16,474,000$$

*Core Deposits Premium over Book Value Method.* This valuation approach is formulated on the announced purchase prices and the percentage premium paid for core deposits over the book value based on the announced transactions of Kerman State Bank's asset-size peer group. Core deposits are all domestic bank deposits excluding accounts in excess of \$100,000. Such deposit data for Kerman State Bank was based on call report data as of December 31, 2001.

The peer group premium on core deposits ranged from 2.49% to 22.52% with the median at 9.50%. The core deposits premium is but one methodology utilized in the determination of overall market value of Kerman State Bank. Utilizing the Core Deposits Premium over Book Value Method (based on Kerman State Bank's adjusted book value as per the merger agreement and its core deposits as of December 31, 2001) the acquisition value, as of the Kerman State Bank fairness opinion report date is as follows:

$$\$54,617,000 \text{ (core deposits as of December 31, 2001)} \times .0950 \text{ (the peer group median)} = \$5,189,000$$

$$\text{plus } \$9,861,000 \text{ (adjusted book value)} = \$15,050,000$$

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*Consideration of Discounted Cash Flow Method.* James H. Avery Company did not employ the discounted cash flow method in its analysis of the proposed Westamerica/ Kerman State Bank merger even though it is aware that the discounted cash flow method is a commonly used valuation methodology. James H. Avery Company believes that the provided methodologies proved adequate for determining the fairness of the consideration to Kerman State Bank's shareholders from a financial standpoint.

**Valuation Summary using Median Comparative Values.**

	<u>Total Value</u>
Multiple of Book Value Method	\$ 15,580,000
Multiple of Income Method	\$ 18,225,000
Percentage of Total Assets Method	\$ 16,474,000
Core Deposits Premium over Book Value Method	\$ 15,050,000
Mean Average	\$ 16,332,000
Median Average	\$ 16,027,000

As previously noted, financial comparisons of Kerman State Bank to the peer-group ratios indicate that the Kerman State Bank valuation be somewhat below the peer group median valuations.

In performing its analyses, James H. Avery Company made numerous assumptions about industry performance, general business and economic conditions and other matters, many of which are beyond the control of Kerman State Bank or Westamerica. The analyses performed are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by those analyses. The analyses were prepared solely as part of James H. Avery Company's analysis as to the fairness of the consideration to holders of shares of Kerman State Bank common stock in the Westamerica/ Kerman State Bank merger. The analyses do not purport to be appraisals or to reflect the prices at which Kerman State Bank might actually be sold or the prices at which any securities may trade at the present time or in the future.

A representative of James H. Avery Company participated in the January 30, 2002 meeting of the board of directors of Kerman State Bank and provided a verbal summary of the Kerman State Bank fairness opinion. James H. Avery Company provided the written Kerman State Bank fairness opinion dated February 5, 2002 regarding the fairness, from a financial point of view, of the consideration to be received by Kerman State Bank in the proposed Westamerica/ Kerman State Bank merger, based on the information then available. As of February 5, 2002, James H. Avery Company is of the opinion that the consideration to be received by Kerman State Bank shareholders in the proposed Westamerica/ Kerman State Bank merger is fair, from a financial standpoint.

A copy of the fairness opinion of James H. Avery Company, dated as of February 5, 2002, which sets forth certain assumptions made, matters considered and limits on the review undertaken by James H. Avery Company, is attached as Appendix B to this proxy statement/prospectus. Shareholders of Kerman State Bank are urged to read the fairness opinion in its entirety.

**Regulatory approvals required**

The merger is subject to approval by the FRB under the Bank Merger Act. This law provides that no transaction may be approved which would result in a monopoly or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States, or the effect of which in any section of the country may be substantially to lessen competition, or to tend to create a monopoly or which in any other manner might restrain trade, unless it is determined that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served. In conducting a review of any application for approval, the FRB is required to consider the financial and managerial resources and future prospects of the banks concerned, their compliance with laws intended to detect and combat money laundering, and the convenience and needs of the community to be served. An

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application may be denied if it is determined that the financial or managerial resources of the acquiring entity are inadequate.

A transaction approved by the FRB may not be consummated for 15 days after the approval. During this period, the Department of Justice may commence legal action challenging the transaction under the antitrust laws. If, however, the Justice Department does not commence a legal action during the 15-day period, it may not thereafter challenge the transaction except in an action commenced under the antimonopoly provisions of Section 2 of the Sherman Antitrust Act.

The Bank Merger Act provides for the publication of notice and the opportunity for administrative hearings relating to the applications for approval and authorize the FRB to permit interested parties to intervene in the proceedings. If an interested party is permitted to intervene, intervention could substantially delay the regulatory approvals required for consummation of the merger.

The merger must also be approved by the California Commissioner of Financial Institutions under the California Financial Code. The factors that the Commissioner will consider in determining whether to grant its approval include the competitive effects of the merger, the convenience and needs of the community, Westamerica's financial condition, the fairness of the merger to the depositors, creditors and shareholders of the parties and the competence, experience and integrity of Westamerica's management.

Based on current precedents, Kerman State Bank and Westamerica believe that the merger will be approved by the appropriate regulatory agencies and will not be subject to challenge by the Department of Justice under the antitrust laws. However, no assurance can be provided that the regulatory agencies or the Department of Justice will concur in this assessment or that any approval by the regulatory agencies will not contain conditions which are materially burdensome to Kerman State Bank or Westamerica.

## **Nasdaq listing**

The shares of Westamerica common stock to be issued in the merger will be included for listing on Nasdaq.

## **Interests of certain officers and directors in the merger**

*Share ownership.* As of April 15, 2002, the record date, the directors and executive officers of Kerman State Bank beneficially owned an aggregate of 308,328 shares of Kerman State Bank common stock (including 11,000 shares subject to presently exercisable options).

*Stock option plans.* As a result of the execution of the merger agreement, all outstanding stock options under Kerman State Bank's stock option plan shall be immediately exercisable to the extent that the terms of the Kerman State Bank option plan provide for such acceleration and if the holder of such options has not terminated his or her employment with Kerman State Bank before the effective date of the merger agreement. Any options not exercised prior to completion of the merger will be converted into options to purchase Westamerica common stock on economically equivalent terms.

*Robert Wheeler's compensation agreement.* The employment agreement for Robert Wheeler, the President of Kerman State Bank, provides that in case of a change in control of the bank, the surviving company will be bound by Mr. Wheeler's employment agreement. Change in control includes a merger in which Kerman State Bank is not the surviving company. Mr. Wheeler's agreement also provides that if, during the twelve month period following the Merger, Mr. Wheeler terminates his employment following a reduction in his duties or title, he will be eligible to receive a single payment equal to six months of his then current base salary, plus any incentive bonus prorated for a partial year of employment.

*Kerman State Bank's severance policy and severance agreements.* Under Kerman State Bank's severance policy, Kerman State Bank has agreed to pay a severance benefit equal to one week's salary for each full year served to any employee terminated during the twelve month period following a merger.

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Some officers of Kerman State Bank have agreements with Kerman State Bank providing for severance benefits in place of (and greater than) the amount provided by the policy. The following severance benefits will be paid if a listed executive officer is terminated during the twelve month period following the merger:

Pete Susoev will receive payment equal to one year's salary (approximately \$74,500) and the bonus (if any) from the immediately preceding year;

Cathy Ponte will receive payment equal to one year's salary (approximately \$50,620) and the bonus (if any) from the immediately preceding year;

Gerald Sullivan will receive payment equal to six months' salary (approximately \$30,000).

## **Accounting treatment**

The merger will be subject to the purchase method of accounting. Under this method of accounting, Kerman State Bank's assets and liabilities will be reflected on Westamerica's future financial statements at their fair market values, and the excess of the aggregate merger consideration above the fair market value of acquired assets and liabilities will be reflected as goodwill or other identifiable intangibles. Intangibles must be valued annually and any impairment written off at the time of the determination of impairment. Intangibles such as those based on core deposits will be amortized over their estimated lives.

## **Certain federal income tax consequences**

Kerman State Bank and Westamerica expect that the merger will qualify as a reorganization under Section 368(a) of the Internal Revenue Code of 1986, as amended and have the following consequences for federal income tax purposes:

The merger will not result in any recognized gain or loss to Kerman State Bank, Westamerica, or Westamerica Bank, and Westamerica Bank will succeed to the carryover basis and the holding period of the assets of Kerman State Bank;

Except for any cash received in lieu of any fractional share or on account of dissenting shares, no gain or loss will be recognized by holders of Kerman State Bank common stock who receive Westamerica common stock in exchange for the shares of Kerman State Bank common stock which they hold;

The holding period of Westamerica common stock issued in exchange for Kerman State Bank common stock will include the holding period of the Kerman State Bank common stock for which it is exchanged, assuming that the shares of Kerman State Bank common stock are capital assets in the hands of the holder thereof at the effective date; and

The basis of the Westamerica common stock received in the exchange will be the same as the basis of the Kerman State Bank common stock for which it was exchanged, decreased by any cash received in the merger for fractional shares and increased by the amount of any gain recognized as a result of the merger.

A shareholder who perfects dissenters' rights and receives payment for his or her Kerman State Bank shares will be treated as if such shares were redeemed. In general, if the shares are held as a capital asset at the time of the merger, the dissenting shareholder will recognize a capital gain or loss measured by the difference between the amount of cash received and the basis of the shares in the hands of the dissenting shareholder. However, if the dissenting shareholder owns, directly or indirectly through the application of Section 318 of the Code, any shares of common stock as to which dissenters' rights are not exercised and perfected and which are therefore exchanged for Westamerica common stock in the merger, the shareholder may be treated as

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having received a dividend in the amount of cash paid to the shareholder in exchange for the shares as to which dissenters' rights were perfected. Under Section 318 of the Code, an individual is deemed to own stock that is actually owned (or deemed to be owned) by certain members of his or her family (spouse, children, grandchildren and parents, with certain exceptions) and other related parties, including, for example, certain entities in which the individual has a direct or indirect interest (including partnerships, estates, trusts and corporations), as well as stock that such individual (or a related person) has the right to acquire upon exercise of an option or conversion right held by such individual (or a related person). Each Kerman State Bank shareholder who intends to dissent from the merger (see *The Merger Dissenters' rights of appraisal*) should consult his or her own tax advisor with respect to the application of the constructive ownership rules to the shareholder's particular circumstances.

For federal tax purposes, the highest marginal tax rate for individuals on ordinary income is 38.6%, compared to 20% for capital gain, and the highest marginal tax rate for corporations is 35% on ordinary income and capital gain. Capital losses are treated differently than ordinary losses. Essentially, a capital loss for any taxable year may be deducted by a corporation in that year only to the extent of capital gain, and by an individual in that year only to the extent of capital gain plus up to \$3,000 of ordinary income. Capital losses not deductible in the year they occur may be carried forward indefinitely by individuals and may be carried back up to three years and forward up to five years by corporations.

Neither Kerman State Bank or Westamerica has requested a ruling from the Internal Revenue Service in connection with the merger. It is a condition to the consummation of the merger that Kerman State Bank and Westamerica have received an opinion from Westamerica's counsel that the merger will constitute a reorganization within the meaning of Section 368(a) of the Code for federal income tax purposes. The tax opinion neither binds the Internal Revenue Service nor precludes the Internal Revenue Service from adopting a contrary position. The tax opinion is subject to certain assumptions and qualifications and is based in part on the truth and accuracy of certain representations of Kerman State Bank, Westamerica and Westamerica Bank.

If the merger fails to qualify as a reorganization under section 368(a) of the Code, then Kerman State Bank shareholders would recognize taxable gain or loss with respect to each share of Kerman State Bank stock surrendered equal to the difference between the shareholder's basis in the share and the sum of the cash and the fair market value, as of the effective time of the merger, of the Westamerica common stock received in exchange for the share. In that event, a shareholder's aggregate basis in the Westamerica common stock so received would equal its fair market value and the shareholder's holding period for that stock would begin on the day after the effective time of the merger. In addition, Kerman State Bank would be treated as if it had made a taxable sale or exchange of its assets.

This proxy statement/prospectus does not provide information about the tax consequences of the merger under any state, local or foreign tax laws. This document does not address all aspects of federal income taxation that may be relevant to a Kerman State Bank shareholder in light of the shareholder's particular circumstances or if the shareholder is subject to special rules. Accordingly, each Kerman State Bank shareholder is urged and expected to consult with such shareholder's own tax advisor to determine the particular United States federal, state, local or foreign income or other tax consequences of the merger. Kerman State Bank and Westamerica will not bear any expenses incurred by any shareholder arising from disputes with the Internal Revenue Service or any state or foreign tax agency over the tax consequences of the merger.

### **Dissenters' rights of appraisal**

Shareholders of Kerman State Bank who do not vote in favor of the merger may be entitled to certain dissenters' appraisal rights under Chapter 13 of the California General Corporation Law. Relevant excerpts of Chapter 13 are provided in Appendix C.

Important details concerning these requirements are provided below; failure to take these actions in a timely and proper fashion will result in the loss of dissenters' appraisal rights.

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The following discussion is not a complete statement of the law relating to dissenters' rights and is qualified in its entirety by reference to Appendix C. This discussion and Appendix C should be reviewed carefully by any shareholder of Kerman State Bank who wishes to exercise dissenters' rights or who wishes to preserve the right to do so, since failure to comply with the procedures in Chapter 13 will result in the loss of dissenters' rights.

If the merger is consummated, those shareholders of Kerman State Bank who elect to exercise their dissenters' rights and who in a timely and proper fashion perfect those rights will be entitled to receive the fair market value of their shares in cash. Under Section 1300(a) of the California General Corporation Law, fair market value would be determined as of the day before the first announcement of the terms of the merger, excluding any appreciation or depreciation caused by the merger. See Summary Comparative Kerman State Bank market price data.

If the merger is approved, Kerman State Bank will, within ten days after the meeting, mail to any shareholder who has a right to require the Kerman State Bank to purchase his or her shares a notice that the required shareholder approval of the merger was obtained. This notice of approval will state the price determined by Kerman State Bank to represent the fair market value of any dissenting shares, and will provide a brief description of the procedures to be followed by dissenting shareholders who wish to exercise their statutory rights. The dissenting shareholder must deliver his or her share certificate(s) for receipt by Kerman State Bank within 30 days after the date on which the notice of approval was mailed to the shareholder. The certificate(s) will be stamped or endorsed with a statement that the shares are dissenting shares and will be returned to the dissenting shareholder.

In order to qualify for dissenters' rights, Kerman State Bank shareholders (i) must make a written demand on Kerman State Bank within 30 days after Kerman State Bank mails to shareholders the notice of approval of the merger and the procedure to be followed, and (ii) must not vote their shares in favor of the merger.

A written demand by a Kerman State Bank shareholder should be sent to Kerman State Bank, P.O. Box 356, Kerman, CA 93630, Attention: Corporate Secretary. The written demand must (i) state the number and class of shares held of record by such shareholder which the shareholder demands that Kerman State Bank purchase for cash, and (ii) contain a statement of the amount which the shareholder claims to be the fair market value of the dissenting shares as of the day before announcement of the proposed merger. That statement will constitute an offer by the shareholder to sell his or her dissenting shares to Kerman State Bank at that price.

The statements in the notice of approval will constitute an offer by Kerman State Bank to purchase from its shareholders any dissenting shares at the price stated, but only if the merger is consummated. However, the determination by Kerman State Bank of fair market value is not binding on its shareholders, and if a dissenting shareholder chooses not to accept such offer, he or she has the right during a period of six months following the mailing of the notice of approval to file a lawsuit to have the fair market value, as described in Section 1300(a), determined by a court. The fair market value of dissenting shares as determined by the court in those circumstances could be higher or lower than the amount offered by Kerman State Bank in the notice of approval or the consideration provided for in merger agreement, and any such determination would be binding on the dissenting shareholder or shareholders involved in the lawsuit and on Kerman State Bank and Westamerica. Any party may appeal from the judgment. However, the court action to determine the fair market value of shares will be suspended if litigation is instituted to test the sufficiency or regularity of the votes of the shareholders in authorizing the merger. No shareholder who has appraisal rights under Chapter 13 will have any right to attack the validity of the merger except in an action to test whether the number of shares required to authorize the merger has been legally voted in favor of the merger.

Dissenting Kerman State Bank shares may lose their status as such if any of the following events occurs:

the merger is abandoned (in which case Kerman State Bank must pay on demand to dissenting shareholders who have initiated proceedings in good faith as provided under Chapter 13 all necessary expenses and reasonable attorneys' fees incurred in such proceedings);

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the dissenting shares are transferred before being submitted to Kerman State Bank for endorsement;

the dissenting shareholder withdraws his or her demand with the consent of Kerman State Bank; or

in the absence of agreement between the dissenting shareholder and Kerman State Bank as to the price of his or her shares, the Kerman State Bank shareholder fails to file suit or otherwise fails to become a party to such suit within six months following the mailing of the notice of approval.

The receipt of a cash payment for dissenting shares will result in recognition of gain or loss for federal and California state income tax purposes by dissenting shareholders. See *The Merger* certain federal income tax consequences.

### **Resales of Westamerica common stock**

The shares of Westamerica common stock to be issued to shareholders of Kerman State Bank under the merger agreement have been registered under the Securities Act, so these shares may be freely traded without restriction by people who will not be affiliates of Westamerica after the merger and who were not affiliates of Kerman State Bank on the date of the special meeting. All directors and certain officers of Kerman State Bank may be considered to have been affiliates of Kerman State Bank. Those people may resell shares of Westamerica common stock to be received by them in the merger only if the shares are registered for resale under the Securities Act or an exemption from such registration under the Securities Act is available. Those people may be permitted to resell the Westamerica shares under the safe harbor provisions of Rule 145 under the Securities Act (or Rule 144 in the case of persons who become affiliates of Westamerica) or as otherwise permitted under the Securities Act. People who may be deemed affiliates of Kerman State Bank or Westamerica generally include individuals or entities that control, are controlled by, or are under common control with, Kerman State Bank or Westamerica, and may include certain officers and directors of such entities as well as principal shareholders of Kerman State Bank or Westamerica. We encourage any such person to obtain advice of securities counsel before reselling any Westamerica shares.

At the time the parties signed the merger agreement, each director and executive officer of Kerman State Bank executed and delivered a written agreement to the effect that such person will not offer or sell or otherwise dispose of any Westamerica common stock received in the merger in violation of the Securities Act or the rules and regulations thereunder.

## **THE MERGER AGREEMENT**

The following is a summary of the material provisions of the merger agreement, a copy of which is attached to this proxy statement/prospectus as Appendix A. The merger agreement is incorporated by reference into this proxy statement/prospectus. You are urged to read the merger agreement in its entirety.

### **Structure of the merger; effective time**

The merger agreement contemplates the merger of Kerman State Bank with and into Westamerica Bank. Westamerica Bank will be the surviving corporation in the merger and will continue its corporate existence under California law. The merger will become effective upon the filing with the California Secretary of State and the DFI of a duly executed merger agreement and officers' certificates required by Section 1103 of the California General Corporation Law unless a different time is provided in the merger agreement. The closing of the merger will take place on a date to be specified by the parties, which will be the earliest practicable day after satisfaction of all of the conditions required by the merger agreement, unless another time or date is agreed to in writing by Westamerica and Kerman State Bank. The merger agreement may be terminated by either Westamerica or Kerman State Bank if, among other reasons, the merger is not consummated on or before September 30, 2002. See *Conditions to the completion of the merger* and *Termination*.



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**Conversion of Kerman State Bank common stock**

If you are a shareholder of Kerman State Bank common stock as of the effective time of the merger, each of your shares of Kerman State Bank common stock will be converted into the right to receive approximately 0.2731 of a share of Westamerica common stock, subject to certain possible adjustments based upon the exchange ratio. Your shares of Kerman State Bank common stock will no longer be outstanding and will be automatically canceled and retired and will cease to exist. Your stock certificate previously representing shares of Kerman State Bank common stock will be exchanged for a certificate representing whole shares of Westamerica common stock.

The exchange ratio (the number of shares of Westamerica common stock into which each share of Kerman State Bank common stock will be converted at closing) is a function of several factors, including Kerman State Bank's adjusted equity (as defined in the merger agreement), amount of performing loans and Significant Liabilities (as defined in the merger agreement). The exchange ratio may be reduced if:

Kerman State Bank's performing loans before closing are less than \$60 million;

Kerman State Bank's allowance for loan losses before closing, determined under Westamerica's methodology, is greater than \$3.2 million;

Kerman State Bank incurs certain obligations defined as Significant Liabilities, which include new unapproved leases and other contractual obligations; capital expenditures above \$25,000; contingent liabilities related to hazardous materials; new or accelerated severance or pension obligations; merger-related expenses above \$470,000; and certain loan loss provisions and write-downs of foreclosed property; or

The average closing price for Westamerica common stock over the 20 trading days ending ten business days before the closing is greater than \$41.76.

The exchange ratio may be increased if:

Kerman State Bank's allowance for loan losses at the month-end before closing, determined under Westamerica's methodology, is less than \$2.4 million; or

Westamerica's average closing price as described above is less than \$33.80.

The adjustments that will be made on account of those factors are interrelated and are described in Section 2.1(a) of the merger agreement. We encourage you to review this text in the merger agreement for this full description of the adjustments that are possible.

The following tables illustrate the exchange ratio and the market value that Kerman State Bank shareholders would receive for each share of Kerman common stock based on certain assumptions and the changes in the exchange ratio that would take effect if certain of the adjustments described above were to be made. The tables below assume an average closing price of Westamerica common stock of \$39.77. No assurance can be given that the actual value of each share of Westamerica common stock upon completion of the merger will be equal to the average closing price used to determine the exchange ratio. Per share

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amount means the exchange ratio multiplied by the assumed value of one share of Westamerica common stock.

	(Dollars in 000s)			
<b>Adjustments to Exchange Ratio</b>				
If Performing Loans are:	\$ 60,000	\$ 56,000	\$ 52,000	
And Adjusted Equity is:	\$ 9,861	\$ 9,861	\$ 9,861	
Exchange ratio would be:	0.2731	0.2598	0.2535	
Per share amount would be:	\$ 10.86	\$ 10.33	\$ 10.08	
If Performing Loans are \$60,000, and				
If the loan loss reserve is adjusted by:	\$ (400)	\$ (200)	\$ 200	\$ 400
Adjusted Equity would be	\$ 10,101	\$ 9,981	\$ 9,741	\$ 9,621
Exchange ratio would be:	0.2797	0.2764	0.2699	0.2667
Per share amount would be:	\$ 11.12	\$ 10.99	\$ 10.74	\$ 10.61
If Performing Loans are \$56,000, and				
If the loan loss reserve is adjusted by:	\$ (400)	\$ (200)	\$ 200	\$ 400
Adjusted Equity would be	\$ 10,101	\$ 9,981	\$ 9,741	\$ 9,621
Exchange ratio would be:	0.2638	0.2618	0.2577	0.2557
Per share amount would be:	\$ 10.49	\$ 10.41	\$ 10.25	\$ 10.17
If Performing Loans are \$60,000, and				
If the loan loss reserve is not adjusted:				
If Significant Liabilities are	\$ 200	\$ 400	\$ 800	
Exchange ratio would be:	0.2604	0.2477	0.2224	
Per share amount would be	\$ 10.36	\$ 9.85	\$ 8.84	
If Performing Loans are \$56,000, and				
If the loan loss reserve is not adjusted:				
If Significant Liabilities are	\$ 200	\$ 400	\$ 800	
Exchange ratio would be:	0.2471	0.2344	0.2167	
Per share amount would be	\$ 9.83	\$ 9.32	\$ 8.62	

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The following table illustrates the effect on the exchange ratio and per share amount received when the average closing price of Westamerica common stock is equal to a range of values between \$31.00 and \$45.00 per share.

Average Closing Price	Final Exchange Ratio	Final Per Share Amount
\$31.00	0.2978	\$ 9.23
32.00	0.2885	9.23
33.00	0.2797	9.23
34.00	0.2731	9.29
35.00	0.2731	9.56
36.00	0.2731	9.83
37.00	0.2731	10.10
38.00	0.2731	10.38
39.00	0.2731	10.65
40.00	0.2731	10.92
41.00	0.2731	11.20
42.00	0.2715	11.40
43.00	0.2652	11.40
44.00	0.2592	11.40
45.00	0.2534	11.40

The merger agreement provides that it is a condition of closing that the aggregate merger consideration be at least \$12,500,000. If the minimum were payable, the per share amount would be approximately \$8.62.

On April 25, 2002, the last reported sale price for Westamerica common stock was \$44.39. The average closing price maybe be higher or lower than this amount.

You will not receive any fractional shares of Westamerica common stock. If you are entitled to a fraction of a share of Westamerica common stock you will, instead, receive an amount in cash. The cash amount will be equal to the closing price as reported on the Nasdaq for the Westamerica common stock on the trading day immediately preceding the closing date, multiplied by the fraction of a share of Westamerica common stock to which you would otherwise been entitled. You will not be entitled to dividends, voting rights, interest on the value of, or any other rights in respect of a fractional share. In the event Westamerica pays, declares or otherwise effects a stock split, reverse stock split, reclassification or stock dividend or stock distribution with respect to Westamerica common stock between the date of the merger agreement and the effective time of the merger, appropriate adjustments will be made to the average Westamerica closing price of Westamerica common stock.

**Options**

At the effective time of the merger, each person holding one or more options to acquire Kerman State Bank common stock which are vested will have the right to exercise any of these options immediately prior to the effective time. Any options that are not vested as of the effective time will be immediately exercisable if the holder of such options has not terminated his or her employment with Kerman State Bank before the effective date of the merger agreement. In addition, a person holding one or more options to acquire Kerman State Bank common stock will have the right to convert those options into a fully vested and exercisable option to purchase shares of Westamerica common stock. The number of shares to be subject to the option to purchase shares of Westamerica common stock will be equal to the product of the number of shares of Kerman State Bank common stock subject to the original option and the exchange ratio (as adjusted), rounded down to the nearest share. The exercise price per share of Westamerica common stock under the new option will be equal to the exercise price per share of Kerman State Bank common stock under the original option divided by the exchange ratio. The exercise price will be rounded up to the nearest cent. In the case of

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any options which are incentive stock options, as defined in Section 422 of the Code, the exercise price, the number of shares purchasable pursuant to such options and the terms and conditions of such options will be determined in order to comply with Section 424(a) of the Code. The duration and other terms of the new options will be the same as those of the original option.

### **Exchange agent; exchange procedure**

Under the merger agreement, Westamerica has agreed to appoint Computershare Investor Services, LLC or its successor, or any other bank or trust company mutually acceptable to Kerman State Bank and Westamerica, as exchange agent for the purpose of exchanging certificates representing the Westamerica common stock which are to be issued under to the merger agreement. As soon as practicable after the effective time of the merger, upon the surrender of your Kerman State Bank shares certificate for cancellation, you will be entitled to receive a certificate representing the number of shares of Westamerica common stock determined in accordance with the merger agreement and a payment in cash with respect to any fractional shares. Do not send in your certificates at this time. Please wait until you receive a transmittal letter with more specific instructions on exchanging your certificates.

You will not receive any dividends or other distributions of any kind which are declared payable to shareholders of record of the shares of Westamerica common stock after the effective time of the merger until you surrender your certificate for shares of Kerman State Bank common stock. When you surrender your Kerman State Bank certificate, you will be paid, without interest, any dividends or other distributions on the shares of Westamerica common stock on which the record date and payment date occurred on or after the effective time of the merger and on or before the date on which you surrendered your certificate for shares of Kerman State Bank common stock.

If you would like your certificate for shares of Westamerica common stock to be issued in a name other than the name or names in which your exchanged Kerman State Bank certificate is registered, you will have to pay to the exchange agent any transfer costs, taxes or other expenses required by reason of the issuance of certificates for such shares of Westamerica common stock in a name other than the registered holder of the exchanged Kerman State Bank certificate.

All dividends or distributions, and any cash to be paid instead of fractional shares, if held by the exchange agent for payment or delivery to the holders of unsurrendered Kerman State Bank certificates representing shares of Kerman State Bank common stock and unclaimed at the end of one year from the effective time of the merger, will (together with any interest earned on those shares) at that time be paid or redelivered by the exchange agent to Westamerica. After that time, if you still have not surrendered your Kerman State Bank certificate, you must look as a general creditor only to Westamerica for payment or delivery of such dividends or distributions or cash, as the case may be.

Neither Westamerica nor the surviving corporation will be liable to you for shares (or dividends or distributions thereon) or cash payable instead of fractional shares delivered to a public official under any applicable abandoned property, escheat or similar law.

### **Representations and warranties**

In the merger agreement, Westamerica and Kerman State Bank make certain customary representations, including those related to the following:

Incorporation, valid existence and authority to conduct business;

Necessary licenses and permits;

Authorization to enter into the merger agreement, and the absence of any material conflict between the merger agreement and other agreements to which each is a party;

Capital structure;

The accuracy of information in regulatory filings;

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The accuracy of representations in the merger agreement, financial statements and this proxy statement/ prospectus;

Compliance with applicable laws;

The performance of contractual obligations;

The absence of any material adverse change or undisclosed liabilities;

The absence of material litigation involving it;

Compliance with ERISA; and

The filing of tax returns and payment of taxes.

Kerman State Bank makes additional representations concerning the following matters:

The absence of any regulatory agreements affecting it;

The status of its insurance coverage and claims;

Title to its assets;

The status of its loan and investment portfolios;

Its responsibility for broker's fees;

Identification of all material contracts to which it is a party;

Identification of all employment contracts to which it is a party, compensation arrangements, and the status of all employee benefit plans;

The absence of hazardous materials on any its properties;

The number and terms of stock options outstanding;

The absence of any severance arrangements that would constitute parachute payments under the Code; and

The absence of any derivatives or similar hedging instruments in its investment portfolio.

**Conduct of business pending the merger**

In the merger agreement, Westamerica and Kerman State Bank make certain covenants. Each agrees to do the following:

Take all necessary action to complete the merger;

Cooperate in preparing and filing a registration statement with the SEC to register the Westamerica common stock being offered to shareholders of Kerman State Bank under this proxy statement/prospectus;

Cooperate in obtaining all necessary government approvals;

Provide each other access to their financial statements;

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Cooperate in the preparation of any press releases; and

Give each other notice of a material adverse change or other event that might prevent the merger from occurring.

In the merger agreement, Kerman State Bank agrees to the following additional actions:

Conduct a shareholders meeting no later than 45 days after the registration statement filed with the SEC to register the Westamerica common stock being offered to shareholders of Kerman State Bank under this proxy statement/ prospectus becomes effective;

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Give Westamerica reasonable access to its books and records, subject to a confidentiality obligation;

Not create any new branches or enter into any new leases of real property;

Not make or approve any increase in the compensation payable or to become payable by Kerman State Bank to some of its directors, officers, employees or agents;

Conduct its operations in the ordinary course of business;

Subject to continuing fiduciary duties, not effect or agree to effect any merger or other business combination;

Not change its capital structure;

Not pay or declare any dividend;

Not change its accounting methods;

Exercise its best efforts to have all of its directors enter into noncompetition agreements;

Consult with Westamerica before making certain credit decisions; and

Continue its internal asset review process in accordance with certain specified procedures.

**Conditions to completion of the merger**

Westamerica's obligation to complete the merger is subject to satisfaction of the following conditions:

The representations of Kerman State Bank shall be accurate;

Kerman State Bank will have performed its obligations under the merger agreements;

Kerman State Bank will not have suffered any material adverse change since September 30, 2001;

Receipt of approval by the shareholders of Kerman State Bank, with the total number of shares of Kerman State Bank common stock held by persons who have dissented not exceeding 9% of the outstanding shares of Kerman State Bank common stock;

Receipt of an officer's certificate signed on behalf of Kerman State Bank by its president/ chief executive officer and its chief financial officer;

Receipt of a customary legal opinion of Kerman State Bank's counsel;

The absence of any legal impediment or burdensome condition to completion of the merger;

Receipt of an order from the SEC declaring the registration statement of Westamerica effective;

Receipt of all required consents and approvals from governmental authorities and third parties;

Receipt of an opinion that the merger will qualify as a tax-free reorganization under the Code;

Receipt of an accountant's assurance letter from Moss Adams, LLP;

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Receipt of Kerman State Bank's most recently prepared unaudited financial statements not later than five business days prior to the effective date;

Receipt of an undertaking letter signed by certain shareholders of Kerman State Bank agreeing not to sell or transfer their Kerman State Bank shares of common stock;

Kerman State Bank will have shareholders' equity equal to at least \$10,161,000;

Kerman State Bank's performing loans will equal or exceed \$52,000,000;

Kerman State Bank's non-interest bearing deposits will equal or exceed \$13,800,000;

Kerman State Bank's significant liabilities will not exceed \$925,000;

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Losses realized by Kerman State Bank from the sale of securities held in Kerman State Bank investment portfolios after September 30, 2001 will be reflected in Kerman State Bank's financial statements;

Kerman State Bank will have satisfied all spending and other commitments required by the merger agreement;

Kerman State Bank will have taken all corrective action recommended by or resulting from its most recent compliance examinations;

Kerman State Bank will have used its best efforts to have delivered an opinion of its loan review examiner to the effect that all loan losses in excess of \$25,000 have been identified on the books of Kerman State Bank;

Kerman State Bank will be in compliance with all requirements arising from its most recent safety and soundness examination;

Each director of Kerman State Bank will have signed and delivered noncompetition agreements to Westamerica within 15 days of the execution of the merger agreement; and

At least three days prior to the closing, Westamerica will have received a letter of resignation from each director of Kerman State Bank. The obligation of Kerman State Bank to complete the merger is subject to satisfaction of the following conditions:

The representations of Westamerica will be accurate;

Westamerica will have performed its obligations under the merger agreement;

Westamerica will not have suffered any material adverse change;

Receipt of an officer's certificate signed on behalf of Westamerica by its chief financial officer;

Receipt of approval by the shareholders of Kerman State Bank;

Receipt of a customary legal opinion of Westamerica's counsel;

Receipt of an order from the SEC declaring the registration statement of Westamerica effective;

Receipt of all required consents and approvals from governmental authorities and third parties;

Receipt of an opinion that the merger will qualify as a tax-free reorganization under the Code;

No legal impediment to the merger will have arisen, and no litigation, proceeding or investigation shall be pending or threatened before any governmental agency relating to the merger;

Receipt of a fairness opinion from its financial advisor which is not revoked before mailing of this proxy statement/prospectus.

The aggregate consideration payable to Kerman State Bank shareholders will not be less than \$12,500,000; and

Kerman State Bank's allowance for loan losses will not be greater than \$3,900,000 as of the effective time.

**Extension; waiver**

At any time prior to the closing of the merger, the parties, by action taken or authorized by each of their board of directors, may, to the extent legally allowed, (1) extend the time for the performance of any of the obligations or other acts of the other parties, (2) waive any inaccuracies in the representations and warranties contained in the merger agreement or in any document delivered pursuant to it, and (3) waive compliance with any of the agreements or conditions contained in the merger agreement. To "waive" means to give up



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rights. Any agreement on the part of a party to the merger agreement to any such extension or waiver shall be valid only if in the form of a written instrument signed on by such party.

### **Termination**

The merger agreement may be terminated under the following circumstances:

by mutual consent of the parties' boards of directors;

by either party on or after September 30, 2002, if the conditions to completion of the merger are not satisfied through no fault of the terminating party;

by Westamerica if on or after September 30, 2002, any conditions to completion of the merger have been fulfilled or waived by Westamerica and Kerman State Bank fails to complete the merger;

by Westamerica if it becomes aware of any facts or circumstances that it was not aware of on the date of the merger agreement which materially adversely affect Kerman State Bank taken as a whole or its properties, operations or financial condition;

by Westamerica if a materially adverse change shall occur after September 30, 2001, in the business, financial condition, results of operations or properties of Kerman State Bank taken as a whole;

by Westamerica if there has been failure on the part of Kerman State Bank to comply with its obligations under the merger agreement;

by Westamerica if Kerman State Bank enters into a transaction with someone other than Westamerica providing for the acquisition of all or a substantial part of Kerman State Bank or its assets;

by Westamerica if any person becomes the beneficial owner of 20% or more of the outstanding shares of Kerman State Bank or any person commences a tender offer or exchange offer to acquire 20% or more of the outstanding shares of Kerman State Bank;

by Westamerica if the board of directors of Westamerica determines that it would be inadvisable or inexpedient to consummate the merger by reason of any material legal impediment to the merger;

by Kerman State Bank if on or after September 30, 2002, any conditions to completion of the merger have been fulfilled or waived by Kerman State Bank and Westamerica fails to complete the merger, provided that Westamerica is not engaged at the time in litigation to obtain one or more governmental approvals necessary to complete the merger, in which case Westamerica will have additional time to complete that litigation and the merger;

by Kerman State Bank if it becomes aware of any facts or circumstances that it was not aware of on the date of the merger agreement and which materially adversely affect Westamerica taken as a whole or its properties, operations or financial condition;

by Kerman State Bank if a materially adverse change shall have occurred since September 30, 2001, in the business, financial condition, results of operations or properties of Westamerica taken as a whole;

by Kerman State Bank if there has been failure on the part of Westamerica to comply with its obligations under the merger agreement;

by Kerman State Bank if Westamerica enters into a transaction with someone providing for the acquisition of all or a substantial part of Westamerica or its assets which does not provide for the assumption of the merger agreement.

### **Expenses; liquidated damages**

Generally, each party has agreed to bear its own expenses in this transaction. However, Kerman State Bank is obligated to pay \$250,000 to Westamerica if Westamerica terminates this Agreement as a result of (i) Kerman State Bank's failure to obtain, or the revocation of, Kerman State Bank's fairness opinion, (ii) Kerman State Bank's failure to obtain approval of its shareholders, (iii) Kerman State Bank's breach of a



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representation, warranty or obligation under the merger agreement. Westamerica shall pay Kerman State Bank a fee of \$250,000 if Kerman State Bank terminates this Agreement as a result of a breach of a representation, warranty or obligation of Westamerica or Westamerica Bank under the merger agreement.

If Kerman State Bank enters into, solicits or encourages a competing transaction, Westamerica may terminate the merger agreement and Kerman State Bank will be liable for a break-up fee of \$1,500,000. If Westamerica enters into a competing transaction that precludes Westamerica from completing the merger, Kerman State Bank may terminate the merger agreement and Westamerica will be liable for a break-up fee of \$1,000,000.

## **Amendment**

The merger agreement may be amended by the parties at any time prior to the effective time without the approval of the shareholders of Westamerica or Kerman State Bank. However, the amendment of any terms relating to the form or amount of consideration to be delivered to the Kerman State Bank shareholders requires the approval of the Kerman State Bank Shareholders.

## **OPERATIONS FOLLOWING THE MERGER**

Upon completion of the merger Kerman State Bank will merge with and into Westamerica Bank. Kerman State Bank's three banking offices located in Kerman, Firebaugh and Easton will become offices of Westamerica Bank.

Westamerica has a branch at 215 South Madera Avenue in Kerman, approximately three blocks or 0.2 miles from the main office of Kerman State Bank at 306 South Madera Avenue. Westamerica expects to consolidate its existing branch into Kerman State Bank's main office and to consolidate Kerman State Bank's administrative office with Westamerica's administrative functions in other offices.

Although we cannot assure you that any specific level of cost savings will be achieved or as to the timing thereof, Westamerica currently expects the surviving corporation to achieve certain cost savings in combined operations following completion of the merger. Westamerica expects to achieve savings through consolidation of the Kerman offices and through elimination of certain executive and back-office positions.

## **INFORMATION ABOUT WESTAMERICA**

### **General**

Westamerica Bancorporation is a bank holding company registered under the Bank Holding Company Act. The company was incorporated under the laws of the State of California as Independent Bankshares Corporation on February 11, 1972. Its headquarters are located at 1108 Fifth Avenue, San Rafael, California 94901, telephone number (415) 257-8000. Its principal administrative offices are located at 4550 Mangels Boulevard, Fairfield, California 94585-1200, and its telephone number is (707) 863-8000. Westamerica provides a full range of banking services to individual and corporate customers in Northern and Central California through its subsidiary bank, Westamerica Bank. The principal communities served are located in Northern and Central California, from Mendocino, Lake, Colusa and Nevada Counties in the North to Kern county in the South. Westamerica's strategic focus is on the banking needs of small businesses. In addition, Westamerica also owns 100 percent of the capital stock of Community Banker Services Corporation, a company engaged in providing the Company and its subsidiaries data processing services and other support functions.

Westamerica was incorporated under the laws of the State of California in 1972 as Independent Bankshares Corporation pursuant to a plan of reorganization among three previously unaffiliated Northern California banks. Westamerica operated as a multi-bank holding company until mid-1983, at which time the then six subsidiary banks were merged into a single bank named Westamerica Bank and the name of the holding company was changed to Westamerica Bancorporation.

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Westamerica acquired five additional banks within its immediate market area during the early to mid 1990 s. Under the terms of the merger agreements, Westamerica issued shares of its common stock in exchange for all of the outstanding shares of the acquired institutions. The subsidiary banks acquired were merged with and into Westamerica Bank. These business combinations were accounted for as pooling-of-interests.

In April, 1997, Westamerica acquired ValliCorp Holdings, Inc., parent company of ValliWide Bank, the largest independent bank holding company headquartered in Central California. The acquisition became effective through the issuance of shares of Westamerica s common stock in exchange for all of the outstanding shares of ValliCorp. The business combination was accounted for as a pooling-of-interests. ValliWide Bank was merged with and into Westamerica Bank.

In August, 2000, Westamerica acquired First Counties Bank. The acquisition was valued at approximately \$19.7 million and was accounted for using the purchase accounting method. The assets and liabilities of First Counties Bank were fully merged into Westamerica Bank in September 2000. First Counties Bank had \$91 million in assets and offices in Lake, Napa, and Colusa counties.

At December 31, 2001, Westamerica had consolidated assets of approximately \$3.9 billion, deposits of approximately \$3.2 billion and shareholders equity of approximately \$314 million.

### **Certain additional business risks**

Westamerica s business, financial condition and operating results can be impacted by a number of factors including, but not limited to, those listed below, any one of which could cause Westamerica s actual results to vary materially from recent results or from Westamerica s anticipated future results.

A portion of the loan portfolio of Westamerica is dependent on real estate. At December 31, 2001, real estate served as the principal source of collateral with respect to approximately 56 percent of Westamerica s loan portfolio. A worsening of current economic conditions, increased economic uncertainty created by the most recent terrorist attacks on the United States and the actions taken in response, or rising interest rates could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, the value of real estate and other collateral securing loans and the value of the available for sale securities portfolio, as well as Westamerica s financial condition and results of operations in general and the market value of Westamerica s common stock. Acts of nature, including earthquakes and floods, which may cause uninsured damage and other loss of value to real estate that secures these loans, may also negatively impact Westamerica s financial condition.

The earnings and growth of Westamerica are affected not only by local market area factors and general economic conditions, but also by government monetary and fiscal policies. Such policies influence the growth of loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact of future changes in such policies on the business and earnings of Westamerica cannot be predicted. Additionally, state and federal tax policies can impact banking organizations.

As a consequence of the extensive regulation of commercial banking activities in the United States, the business of Westamerica is particularly susceptible to being affected by the enactment of federal and state legislation which may have the effect of increasing or decreasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Any change in applicable laws or regulations may have a material adverse effect on the business and prospects of Westamerica.

Westamerica is also subject to certain operations risks, including, but not limited to, data processing system failures and errors and customer or employee fraud. Westamerica maintains a system of internal controls to mitigate against such occurrences and maintains insurance coverage for such risks, but should such an event occur that is not prevented or detected by Westamerica s internal controls, is not insured or is in excess of applicable insurance limits, it could have a significant adverse impact on Westamerica s business, financial condition or results of operations.

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Shares of Westamerica common stock eligible for future sale could have a dilutive effect on the market for Westamerica common stock and could adversely affect the market price. The articles of incorporation of Westamerica authorize the issuance of 150 million shares of common stock (and two classes of one million shares each, denominated Class B Common Stock and Preferred Stock, respectively) of which approximately 34.2 million were outstanding at December 31, 2001. Pursuant to its stock option plans, at December 31, 2001, Westamerica had exercisable options outstanding for 1.6 million shares. As of December 31, 2001, 1.4 million additional shares of Westamerica common stock remained available for grants under Westamerica's stock option plans (and stock purchase plan). Sales of substantial amounts of Westamerica common stock in the public market could adversely affect its market price of common stock.

## **Employees**

At December 31, 2001, the company and its subsidiaries employed 1,066 full-time equivalent staff. Employee relations are believed to be good.

## **Branch offices and facilities**

Westamerica's banks are engaged in the banking business through 90 offices in 23 counties in Northern and Central California, including eleven offices each in Marin County and in Fresno County, nine in Sonoma County, seven in Napa County, six each in Solano, Kern, Stanislaus and Contra Costa Counties, five in Lake County, three each in Mendocino and Sacramento Counties, two each in Nevada, Placer, Tulare, Tuolumne and Alameda Counties, one each in San Francisco, Kings, Madera, Merced, Yolo and Colusa Counties. All offices are constructed and equipped to meet prescribed security requirements.

The company owns 31 branch office locations and one administrative building and leases 69 offices and other facilities. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

## **The effect of government policy on banking**

The earnings and growth of Westamerica are affected not only by local market area factors and general economic conditions, but also by government monetary and fiscal policies. Such policies influence the growth of loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact of future changes in such policies on the business and earnings of Westamerica cannot be predicted. Additionally, state and federal tax policies can impact banking organizations. As a consequence of the extensive regulation of commercial banking activities in the United States, the business of Westamerica is particularly susceptible to being affected by the enactment of federal and state legislation which may have the effect of increasing or decreasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Any change in applicable laws or regulations may have a material adverse effect on the business and prospects of Westamerica.

## **Regulation and supervision of bank holding companies**

The following is not intended to be an exhaustive description of the statutes and regulations applicable to Westamerica's or the Westamerica Bank's business. The description of statutory and regulatory provisions is qualified in its entirety by reference to the particular statutory or regulatory provisions.

Moreover, major new legislation and other regulatory changes affecting Westamerica, Westamerica Bank, banking, and the financial services industry in general have occurred in the last several years and can be expected to occur in the future. The nature, timing and impact of new and amended laws and regulations cannot be accurately predicted.

Westamerica is a bank holding company subject to the Bank Holding Company Act. Westamerica reports to, registers with, and may be examined by, the FRB. The FRB also has the authority to examine Westamerica's subsidiaries. The costs of any examination by the FRB are payable by Westamerica.





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Westamerica is a bank holding company within the meaning of Section 3700 of the California Financial Code. As such, Westamerica and Westamerica Bank are subject to examination by, and may be required to file reports with, the Commissioner.

The FRB has significant supervisory and regulatory authority over Westamerica and its affiliates. The FRB requires Westamerica to maintain certain levels of capital. See *Capital Standards*. The FRB also has the authority to take enforcement action against any bank holding Westamerica that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. See *Prompt Corrective Action and Other Enforcement Mechanisms*. Under the Bank Holding Company Act, a company generally must obtain the prior approval of the FRB before it exercises a controlling influence over a bank, or acquires directly or indirectly, more than 5% of the voting shares or substantially all of the assets of any bank or bank holding company. Thus, Westamerica is required to obtain the prior approval of the FRB before it acquires, merges or consolidates with any bank or bank holding company. Any company seeking to acquire, merge or consolidate with Westamerica also would be required to obtain the prior approval of the FRB.

Westamerica is generally prohibited under the Bank Holding Company Act from acquiring ownership or control of more than 5% of the voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than banking, managing banks, or providing services to affiliates of the holding Westamerica. However, a bank holding company, with the approval of the FRB, may engage, or acquire the voting shares of companies engaged, in activities that the FRB has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. A bank holding company must demonstrate that the benefits to the public of the proposed activity will outweigh the possible adverse effects associated with such activity.

A bank holding company may acquire banks in states other than its home state without regard to the permissibility of such acquisitions under state law, but subject to any state requirement that Westamerica Bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company, prior to or following the proposed acquisition, controls no more than 10% of the total amount of deposits of insured depository institutions in the United States and no more than 30% of such deposits in that state (or such lesser or greater amount set by state law). Banks may also merge across states lines, thereby creating interstate branches. Furthermore, a bank is now able to open new branches in a state in which it does not already have banking operations, if the laws of such state permit such de novo branching.

Under California law, (a) out-of-state banks that wish to establish a California branch office to conduct core banking business must first acquire an existing five year old California bank or industrial bank by merger or purchase, (b) California state-chartered banks are empowered to conduct various authorized branch-like activities on an agency basis through affiliated and unaffiliated insured depository institutions in California and other states and (c) the commissioner is authorized to approve an interstate acquisition or merger that would result in a deposit concentration exceeding 30% if the Commissioner finds that the transaction is consistent with public convenience and advantage. However, a state bank chartered in a state other than California may not enter California by purchasing a California branch office of a California bank or industrial bank without purchasing the entire entity or by establishing a de novo California bank.

The FRB generally prohibits a bank holding company from declaring or paying a cash dividend that would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements which might adversely affect a bank holding company's financial position. Under the FRB policy, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. See the section entitled *Restrictions on dividends and other distributions* for additional restrictions on the ability of Westamerica and Westamerica Bank to pay dividends.

Transactions between Westamerica and Westamerica Bank are subject to a number of other restrictions. FRB policies forbid the payment by bank subsidiaries of management fees, which are unreasonable in amount

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or exceed the fair market value of the services rendered (or, if no market exists, actual costs plus a reasonable profit). Subject to certain limitations, depository institution subsidiaries of bank holding companies may extend credit to, invest in the securities of, purchase assets from, or issue a guarantee, acceptance, or letter of credit on behalf of, an affiliate, provided that the aggregate of such transactions with affiliates may not exceed 10% of the capital stock and surplus of the institution, and the aggregate of such transactions with all affiliates may not exceed 20% of the capital stock and surplus of such institution. Westamerica may only borrow from Westamerica Bank if the loan is secured by marketable obligations with a value of a designated amount in excess of the loan. Further, Westamerica may not sell a low-quality asset to a depository institution subsidiary. Comprehensive amendments to federal regulations governing bank holding companies and change in bank control (Regulation Y) became effective in 1997, and are intended to improve the competitiveness of bank holding companies by, among other things: (i) expanding the list of permissible nonbanking activities in which well-run bank holding companies may engage without prior FRB approval, (ii) streamlining the procedures for well-run bank holding companies to obtain approval to engage in other nonbanking activities and (iii) eliminating most of the anti-tying restrictions prescribed for bank holding companies and their nonbank subsidiaries. Amended Regulation Y also provides for a streamlined and expedited review process for bank acquisition proposals submitted by well-run bank holding companies and eliminates certain duplicative reporting requirements when there has been a further change in bank control or in bank directors or officers after an earlier approved change. These changes to Regulation Y are subject to numerous qualifications, limitations and restrictions. In order for a bank holding company to qualify as well-run, both it and the insured depository institutions which it controls must meet the well capitalized and well managed criteria in Regulation Y.

To qualify as well capitalized, the bank holding company must, on a consolidated basis: (i) maintain a total risk-based capital ratio of 10% or greater; (ii) maintain a Tier 1 risk-based capital ratio of 6% or greater; and (iii) not be subject to any order by the FRB to meet a specified capital level. Its lead insured depository institution must be well capitalized as that term is defined in the capital adequacy regulations of the applicable bank regulator, 80% of the total risk-weighted assets held by its insured depository institutions must be held by institutions which are well capitalized, and none of its insured depository institutions may be undercapitalized.

To qualify as well managed : (i) each of the bank holding company, its lead depository institution and its depository institutions holding 80% of the total risk-weighted assets of all its depository institutions at their most recent examination or review must have received a composite rating, rating for management and rating for compliance which were at least satisfactory; (ii) none of the bank holding company s depository institutions may have received one of the two lowest composite ratings; and (iii) neither the bank holding company nor any of its depository institutions during the previous 12 months may have been subject to a formal enforcement order or action.

On March 11, 2000, the Gramm-Leach-Bliley Act (the GLBA ), or the Financial Services Act of 1999 became effective. The GLBA repealed provisions of the Glass-Steagall Act, which had prohibited commercial banks and securities firms from affiliating with each other and engaging in each other s businesses. Thus, many of the barriers prohibiting affiliations between commercial banks and securities firms have been eliminated.

The Bank Holding Company Act was also amended by the GLBA to allow new financial holding companies ( FHCs ) to offer banking, insurance, securities and other financial products to consumers. Specifically, the GLBA amended section 4 of the Bank Holding Company Act in order to provide for a framework for the engagement in new financial activities. A bank holding company may elect to become a FHC if all its subsidiary depository institutions are well capitalized and well managed. If these requirements are met, a bank holding company may file a certification to that effect with the FRB and declare that it elects to become a FHC. After the certification and declaration is filed, the FHC may engage either de novo or through an acquisition in any activity that has been determined by the FRB to be financial in nature or incidental to such financial activity. bank holding companies may engage in financial activities without prior notice to the FRB if those activities qualify under the new list of permissible activities in section 4(k) of the Bank Holding Company Act. However, notice must be given to the FRB within 30 days after a FHC has commenced one or more of the financial activities. Westamerica has not elected to become a FHC.

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Under the GLBA, Federal Reserve member banks, subject to various requirements, as well as national banks, are permitted to engage through financial subsidiaries in certain financial activities permissible for affiliates of FHCs. However, to be able to engage in such activities Westamerica Bank must also be well capitalized and well managed and have received at least a satisfactory rating in its most recent CRA examination. Westamerica cannot be certain of the effect of the foregoing recently enacted legislation on its business, although there is likely to be consolidation among financial services institutions and increased competition for Westamerica.

### **Bank supervision and regulation**

Westamerica Bank is a California state-chartered bank, is insured by the Federal Deposit Insurance Corporation (the FDIC) and is a member bank of the FRB. As such, Westamerica Bank is subject to regulation, supervision and regular examination by the DFI and the FRB. As a member bank of the FRB, Westamerica Bank's primary federal regulator is the FRB. The regulations of these agencies affect most aspects of Westamerica Bank's business and prescribe permissible types of loans and investments, the amount of required reserves, requirements for branch offices, the permissible scope of its activities and various other requirements.

In addition to federal banking law, Westamerica Bank is also subject to applicable provisions of California law. Under California law, Westamerica Bank is subject to various restrictions on, and requirements regarding, its operations and administration including the maintenance of branch offices and automated teller machines, capital requirements, deposits and borrowings, stockholder rights and duties, and investment and lending activities.

California law permits a state chartered bank to invest in the stock and securities of other corporations, subject to a state-chartered bank receiving either general authorization or, depending on the amount of the proposed investment, specific authorization from the Commissioner. The Federal Deposit Insurance Corporation Improvement Act (FDICIA), however, imposes limitations on the activities and equity investments of state chartered, federally insured banks. FDICIA also prohibits a state bank from engaging as a principal in any activity that is not permissible for a national bank, unless Westamerica Bank is adequately capitalized and the FDIC approves the activity after determining that such activity does not pose a significant risk to the deposit insurance fund. The FDIC rules on activities generally permit subsidiaries of banks, without prior specific FDIC authorization, to engage in those activities which have been approved by the FRB for bank holding companies because such activities are so closely related to banking as to be a proper incident thereto. Other activities generally require specific FDIC prior approval, and the FDIC may impose additional restrictions on such activities on a case-by-case basis in approving applications to engage in otherwise impermissible activities.

### **Capital standards**

The federal banking agencies have risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions such as letters of credit and recourse arrangements, which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as certain loans.

In determining the capital level Westamerica Bank is required to maintain, the federal banking agencies do not, in all respects, follow generally accepted accounting principles (GAAP) and have special rules which have the effect of reducing the amount of capital they will recognize for purposes of determining its capital adequacy. A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off balance sheet items. The regulators measure risk-adjusted assets and off balance sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, qualifying

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noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets and other adjustments. Net unrealized losses on available for sale equity securities with readily determinable fair value must be deducted in determining Tier 1 capital. For Tier 1 capital purposes, deferred tax assets which can only be realized if an institution earns sufficient taxable income in the future are limited to the amount that the institution is expected to realize within one year, or ten percent of Tier 1 capital, whichever is less. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses, term preferred stock and other types of preferred stock not qualifying as Tier 1 capital, hybrid capital instruments and mandatory convertible debt securities, term subordinated debt and certain other instruments with some characteristics of equity and limited amounts of unrealized holding gains on equity securities. The inclusion of elements of Tier 2 capital are subject to certain other requirements and limitations of the federal banking agencies. The federal banking agencies require a minimum ratio of qualifying total capital to risk-adjusted assets and off balance sheet items of 8%, and a minimum ratio of Tier 1 capital to adjusted average risk-adjusted assets and off balance sheet items of 4%.

In addition to the risk-based guidelines, the federal banking agencies require banking organizations to maintain a minimum amount of Tier 1 capital to adjusted average total assets, referred to as the leverage capital ratio. For a banking organization rated in the highest of the five categories used to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3%. It is improbable, however, that an institution with a 3% leverage ratio would receive the highest rating since a strong capital position is a significant part of the regulators rating. For all banking organizations not rated in the highest category, the minimum leverage ratio must be at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, must be at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios which apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

As of December 31, 2001, Westamerica's and Westamerica Bank's respective ratios exceeded applicable regulatory requirements. See Note 8 to the consolidated financial statements for capital ratios of Westamerica and Westamerica Bank, compared to the standards for well capitalized depository institutions and for minimum capital requirements.

The federal banking agencies take into consideration concentrations of credit risk and risks from nontraditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's capital. This evaluation is made as a part of the institution's regular safety and soundness examination. The federal banking agencies also consider interest rate risk (when the interest rate sensitivity of an institution's assets does not match the sensitivity of its liabilities or its off balance sheet position) in evaluation of a bank's capital adequacy.

## **Prompt corrective action and other enforcement mechanisms**

FDICIA requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. The law required each federal banking agency to promulgate regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

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Under the prompt corrective action provisions of FDICIA, an insured depository institution generally will be classified in the following categories based on the capital measures indicated below:

	<b>Total Risk-Based Capital</b>	<b>Tier 1 Risk-Based Capital</b>	<b>Leverage Ratio</b>
Well capitalized	10.00%	6.00%	5.00%
Adequately capitalized	8.00	4.00	4.00
Undercapitalized (less than)	8.00	4.00	4.00
Significantly undercapitalized (less than)	6.00	3.00	3.00
Critically undercapitalized			
Tangible equity/total assets (less than)	2.00		

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation or any condition imposed in writing by the agency or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding Westamerica's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding Westamerica.

**Safety and soundness standards**

FDICIA also implemented certain specific restrictions on transactions and required federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts. The federal banking agencies may require an institution to submit to an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution's noncompliance with one or more standards.

**Restrictions on dividends and other distributions**

The power of the board of directors of an insured depository institution to declare a cash dividend or other distribution with respect to capital is subject to statutory and regulatory restrictions which limit the amount available for such distribution depending upon the earnings, financial condition and cash needs of the institution, as well as general business conditions. FDICIA prohibits insured depository institutions from paying management fees to any controlling persons or, with certain limited exceptions, making capital distributions, including dividends, if, after such transaction, the institution would be undercapitalized.

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In addition to the restrictions imposed under federal law, banks chartered under California law generally may only pay cash dividends to the extent such payments do not exceed the lesser of retained earnings of the bank or the bank's net income for its last three fiscal years (less any distributions to shareholders during this period). In the event a bank desires to pay cash dividends in excess of such amount, the bank may pay a cash dividend with the prior approval of the Commissioner in an amount not exceeding the greatest of the bank's retained earnings, the bank's net income for its last fiscal year or the bank's net income for its current fiscal year.

The federal banking agencies also have the authority to prohibit a depository institution from engaging in business practices which are considered to be unsafe or unsound, possibly including payment of dividends or other payments under certain circumstances even if such payments are not expressly prohibited by statute.

### **Premiums for deposit insurance and assessments for examinations**

Westamerica Bank's deposits are insured by the Bank Insurance Fund ( BIF ) administered by the FDIC. FDICIA established several mechanisms to increase funds to protect deposits insured by the BIF administered by the FDIC. The FDIC is authorized to borrow up to \$30 billion from the United States Treasury; up to 90% of the fair market value of assets of institutions acquired by the FDIC as receiver from the Federal Financing Bank; and from depository institutions which are members of the BIF. Any borrowings not repaid by asset sales are to be repaid through insurance premiums assessed to member institutions. Such premiums must be sufficient to repay any borrowed funds within 15 years and provide insurance fund reserves of \$1.25 for each \$100 of insured deposits. FDICIA also provides authority for special assessments against insured deposits. No assurance can be given at this time as to what the future level of insurance premiums will be.

### **CRA and fair lending developments**

Westamerica Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act ( CRA ) activities. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of their local communities, including low and moderate income neighborhoods. In addition to substantive penalties and corrective measures that may be required for a violation of certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities.

### **Financial privacy legislation**

The GLBA, in addition to the previously described changes in permissible nonbanking activities permitted to banks, bank holding companies and FHCs, also required the federal banking agencies, among other federal regulatory agencies, to adopt regulations governing the privacy of consumer financial information. The FRB adopted such regulations with an effective date of November 13, 2000, and a date of full compliance with the regulations of July 1, 2001. Westamerica Bank is subject to the FRB's regulations.

The regulations impose three main requirements established by the GLBA. First, a banking organization must provide initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates, such as Westamerica. Second, banking organizations must provide annual notices of their privacy policies to their current customers. Third, banking organizations must provide a reasonable method for consumers to opt-out of disclosures to nonaffiliated third parties.

In connection with the regulations governing the privacy of consumer financial information, the federal banking agencies, including the FRB, adopted guidelines for safeguarding confidential customer information, effective on July 1, 2001. The guidelines require banking organizations to establish an information security program to: (1) identify and assess the risks that may threaten customer information; (2) develop a written plan containing policies and procedures to manage and control these risks; (3) implement and test the plan; and (4) adjust the plan on a continuing basis to account for changes in technology, the sensitivity of customer

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information, and internal or external threats. The guidelines also outline the responsibilities of directors of banking organizations in overseeing the protection of customer information.

### **Recently enacted legislation and regulations**

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 or the USA Patriot Act. Title III of the Act is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. It includes numerous provisions for fighting international money laundering and blocking terrorist access to the U.S. financial system. The goal of Title III is to prevent the U.S. financial system and the U.S. clearing mechanisms from being used by parties suspected of terrorism, terrorist financing and money laundering.

The provisions of Title III of the USA Patriot Act which affect banking organizations, including Westamerica Bank, are generally set forth as amendments to the Bank Secrecy Act. These provisions relate principally to U.S. banking organizations relationships with foreign banks and with persons who are resident outside the United States. The USA Patriot Act does not immediately impose any new filing or reporting obligations for banking organizations, but does require certain additional due diligence and record keeping practices. Some requirements take effect without the issuance of regulations. Other provisions are to be implemented through regulations that will be promulgated by the U.S. Department of the Treasury (the Treasury), in consultation with the FRB and other federal financial institutions regulators.

At this time, numerous provisions of Title III of the USA Patriot Act require implementing regulations or interpretations from the Treasury. Consequently, the effect of the USA Patriot Act on the business of Westamerica and Westamerica Bank cannot be accurately predicted at this time.

### **Pending legislation and regulations**

Certain pending legislative proposals include bills to permit banks to pay interest on business checking accounts, to cap consumer liability for stolen debit cards, to end certain predatory lending practices, to allow the payment of interest on reserves that financial institutions must keep with FRB and to give judges the authority to force high-income borrowers to repay their debts rather than cancel them through bankruptcy. A proposal to merge the FDIC's two funds, the BIF and the Savings Association Insurance Fund, is also being discussed.

While the effect of such proposed legislation on the business of Westamerica cannot be accurately predicted at this time, it seems likely that a significant amount of consolidating in banking industry will continue.

## **INFORMATION ABOUT KERMAN STATE BANK**

### **General**

Kerman State Bank engages in the general commercial banking business in the Central San Joaquin Valley in the State of California from its headquarters banking office located at 306 South Madera Avenue, Kerman, California and its branches located at 5751 South Elm Street, Easton, California, and 1312 P Street, Firebaugh, California. Kerman State Bank is an insured bank under the Federal Deposit Insurance Act and is not a member of the FRB.

Kerman State Bank conducts a commercial banking business which includes accepting demand, savings and time deposits and making real estate, commercial, and installment loans. Although Kerman State Bank has a diversified loan portfolio, a significant portion of its customers ability to repay loans is dependent upon the agricultural sector, as its customer base is centralized in one of the largest agricultural areas in the world. It is generally Kerman State Bank's policy to fully collateralize loans; however, this is determined on an individual basis, taking into account the financial stability of each borrower. The collateral held by Kerman State Bank may include cash, equipment, accounts receivable, inventories, securities and real estate.

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At December 31, 2001, the total of Kerman State Bank's installment and credit card loans outstanding were \$1,853,181, the total of commercial loans outstanding was \$12,556,091, the total of agricultural loans outstanding was \$28,536,807, and the total of real estate loans outstanding was \$12,556,091 (including \$12,050,560 in loans secured by farmland, including farm residential and other improvements), representing 5%, 20%, 44% and 33%, respectively, of Kerman State Bank's loan portfolio.

The majority of Kerman State Bank's real estate lending activities are limited to Central San Joaquin Valley farm, commercial and residential properties. Real estate secured loans are generally written at fixed rates of interest and have maturities ranging from one to seven years. Variable rate real estate loans may have longer maturities. Kerman State Bank, from time to time, makes interim construction loans to well-established contractors and/or developers who have take-out financing. Kerman State Bank generally does not do take-out loans or permanent real estate financing. However, permanent financing may be extended on income property with sufficient cash flow to support debt payments. Real estate loans are usually extended on properties at 70-80% of the cost or appraised value of the property, whichever is lowest. At December 31, 2001, Kerman State Bank's real estate loan portfolio consisted of approximately 49% farm properties, 26% residential properties and 25% commercial properties.

Real estate values remained relatively stable during 2001 with a slight upturn in market values for residential properties in the fourth quarter. Commercial property values also remained stable, but sales activity continued to be weak throughout the year.

From 1999 through 2001, Kerman State Bank charged off five real estate loans in the aggregate amount of approximately \$1,100,000 (in addition to charge-offs of \$537,000 for non-real estate loans). Additionally, as of December 31, 2001, Kerman State Bank held three properties as other real estate owned (OREO), consisting mostly of real property acquired through, or in lieu of, foreclosure with an aggregate carrying value of \$2,492,000.

Kerman State Bank's deposits are obtained from local individuals, business and farmers. Kerman State Bank historically has attracted a significant portion of its total deposits in the form of time certificates. These large deposits represent approximately 41% of the total deposits of Kerman State Bank. The vast majority of these deposits have been maintained with Kerman State Bank for many years with no appreciable evidence of volatility. Within that group of depositors are several relationships that, in aggregate may represent a concentration. Kerman State Bank monitors those relationships and factors the potential adverse effect of withdrawal into its liquidity management program. Other than jumbo deposits there are no other identified deposit segments which would have a material adverse effect on the business of Kerman State Bank.

Kerman State Bank entertains and grants various extensions of credit to local farmers. Since raisin production is the principal crop in Kerman State Bank's market area, Kerman State Bank's loan portfolio contains a significant amount of loans that rely on raisin proceeds for repayment. The risks of an industry concentration is that if the particular industry suffers an economic downturn the ability to repay loans to specific borrowers within the industry may be negatively impacted. This concentration is closely monitored and the Kerman State Bank allocates within its loan loss reserve methodology a specific amount believed reasonable for additional loss potential. Also, the Kerman State Bank maintains a capital ratio percentage related to the total amount of raisin reliant loans at any given time. Other than the concentration within the raisin industry, and/or agricultural lending in general, there are no other identified loan portfolio segments, which would have a material adverse effect on the business of Kerman State Bank.

In order to attract loan and deposit business from individuals and small businesses, Kerman State Bank maintains lobby hours from 9:00 A.M. to 4:00 P.M., Monday through Thursday and from 9:00 A.M. to 6:00 P.M. on Friday. Kerman State Bank also maintains drive-up window hours from 8:30 A.M. to 5:00 P.M., Monday through Thursday and from 8:30 A.M. to 6:00 P.M. on Friday. One automated teller machine (one walk-up) operates 24 hours per day, seven days per week, at Kerman State Bank's headquarters banking office.



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Kerman State Bank relies substantially on local promotional activity, personal contacts by its officers, directors and employees, referrals by its shareholders, extended hours, personalized service and its reputation in the communities it serves to compete effectively.

As of December 31, 2001, there were three operating bank offices in Kerman, California. Kerman also contains one office of a savings and loan association. Firebaugh has two operating bank offices. Easton does not contain any offices of banks or savings and loan associations. Kerman State Bank's primary service area is oriented to small businesses and agriculture.

The banking business in California generally, and in Kerman State Bank's primary service area specifically, is highly competitive with respect to both loans and deposits, and is dominated by a relatively small number of major banks with many offices operating over a wide geographic area. Among the advantages such major banks have over Kerman State Bank are their ability to finance wide-ranging advertising campaigns and to allocate their investment assets, including loans, to regions of higher yield and demand. Such banks offer certain services such as international banking and trust services which are not offered directly by Kerman State Bank but which Kerman State Bank has offered indirectly through correspondent institutions when its customers sought these services. In addition, by virtue of their greater total capitalization, such banks have substantially higher lending limits than Kerman State Bank. Legal lending limits to an individual customer are limited to a percentage of a bank's total capital accounts. As of December 31, 2001, Kerman State Bank's loan limits to individual customers were approximately \$1,927,270 for unsecured loans and \$5,144,730 for unsecured and secured loans combined. For borrowers desiring loans in excess of Kerman State Bank's lending limits, Kerman State Bank may, in the future, make such loans on a participation basis with its correspondent banks taking the amount of loans in excess of Kerman State Bank's lending limits. In other cases, Kerman State Bank may refer such borrowers to larger banks or other lending institutions.

## **Supervision and regulation**

As a California state-licensed bank, Kerman State Bank is subject to regulation, supervision and periodic examination by the DFI and the FDIC. Kerman State Bank is not a member of the FRB, but is nevertheless subject to certain regulations of the Federal Reserve. Kerman State Bank's deposits are insured by the FDIC to the maximum amount permitted by law, which is currently \$100,000 per depositor in most cases.

The regulations of these state and federal bank regulatory agencies govern most aspects of the Kerman State Bank's business and operations, including but not limited to, the scope of its business, its investments, its reserves against deposits, the nature and amount of any collateral for loans, the timing of availability of deposited funds, the issuance of securities, the payment of dividends, bank expansion and bank activities, including real estate development and insurance activities, and the maximum rates of interest allowed on certain deposits. Kerman State Bank is also subject to the requirements and restrictions of various consumer laws and regulations.

Most of the laws and regulations described above under Information about Westamerica Regulation and supervision of banks, Capital standards, Prompt corrective action and other enforcement mechanisms, Safety and soundness standards, Restrictions on dividends and other distributions, Premiums for deposit insurance and assessments for examinations, CRA and fair lending developments, Financial privacy legislation, Recently enacted legislation and regulations, and Pending legislation and regulations apply equally to Kerman State Bank.

The following section summarize the application of certain statutory and regulatory provisions and proposals to Kerman State Bank and is not intended to be a complete description of these provisions and is qualified in its entirety by reference to the particular statutory or regulatory provisions discussed.

## **Capital adequacy requirements**

Kerman State Bank is subject to the FDIC's regulations governing capital adequacy for nonmember banks. Additional capital requirements may be imposed on banks based on market risk.

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Set forth below are the Kerman State Bank's risk based and leverage capital ratios as of December 31, 2001:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in 000s)						
Total capital (to risk-weighted assets)	\$ 12,524	16.39%	\$ 6,115	8.0%	\$ 7,643	10.0%
Tier 1 capital (to risk-weighted assets)	11,564	15.13%	3,057	4.0%	4,586	6.0%
Leverage (to average assets)	11,564	11.24%	4,114	4.0%	5,143	5.0%

On October 25, 2001, Kerman State Bank entered into an agreement with the FDIC and the DFI. The board of directors agreed to reduce the level of classified and non-accrual loans, develop and implement a plan with specific strategies to diversify the loan portfolio and reduce concentration of credit, revise the bank's lending and collection policies and review the allowance for loan loss for adequacy each quarter. The FDIC and DFI also required the bank to maintain a Tier 1 leverage capital ratio of at least nine percent and not pay a dividend without prior consent of the FDIC and DFI. Management believes that they have complied with the provisions of the agreement. The FDIC and DFI terminated the agreement on March 14, 2002.

**Activities of subsidiaries of state non-member banks**

In January 2001, the FDIC adopted final regulations implementing Section 121 of Title I, regarding permissible activities and investments of insured state banks. The regulations, in the form of amendments to Part 362 of the FDIC rules and regulations, provide the framework for subsidiaries of state nonmember banks to engage in financial activities that the GLBA permits national banks to conduct through a financial subsidiary. The regulations require that prior to commencing such financial activities, a state nonmember bank must notify the FDIC of its intent to do so, and must certify that it is well-managed and that it and all of its subsidiary insured depository institutions are well-capitalized after deducting its investment in the new subsidiary. Furthermore, the regulations require that the notifying bank must, and must continue to, (i) disclose the capital deduction in published financial statements, and (ii) comply with sections 23A and 23B of the Federal Reserve Act and (iii) comply with all required financial and operational safeguards.

Activities permissible for financial subsidiaries of national banks, and pursuant to Section 362 of the FDIC rules and regulations are permissible for financial subsidiaries of state nonmember banks, include, but are not limited to, the following: (a) Lending, exchanging, transferring, investing for others, or safeguarding money or securities; (b) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State; (c) Providing financial, investment, or economic advisory services, including advising an investment company; (d) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; and, (e) Underwriting, dealing in, or making a market in securities.

Additionally, the FDIC, pursuant to authority granted under Section 24 of the FDI Act, has the authority to approve applications from state nonmember banks to engage in activities that are prohibited to national banks and their financial subsidiaries.

**Privacy**

As required under Title V of the GLBA, federal banking regulators issued final rules on May 10, 2000 to implement the privacy provisions of Title V. Pursuant to the rules, financial institutions must provide (i) initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates; (ii) annual notices of their privacy policies to current customers; and (iii) a reasonable method for customers to opt out of disclosures to nonaffiliated third parties.

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Compliance with the rules was optional until July 1, 2001. As of July 1, 2001 Kerman State Bank was in compliance with the privacy provisions of the GLBA and the implementing regulations promulgated by the FDIC.

### **Safeguarding confidential customer information**

In compliance with federal guidelines under GLBA, Kerman State Bank implemented a security program appropriate to its size and complexity and the nature and scope of its operations in advance of the July 1, 2001 effective date.

### **CRA sunshine requirements**

In February 2001, the federal banking agencies adopted final regulations implementing Section 711 of Title 7, the CRA Sunshine Requirements. The regulations require non-governmental entities or persons and insured depository institutions and affiliates that are parties to written agreements made in connection with the fulfillment of the institution's CRA obligations to make available to the public and the federal banking agencies a copy of each such agreement. The regulations impose annual reporting requirements concerning the disbursement, receipt and use of funds or other resources under each such agreement. The effective date of the regulations was April 1, 2001.

Kerman State Bank is not a party to any agreement that would be subject of reporting pursuant to the CRA Sunshine Requirements.

Kerman State Bank intends to comply with all provisions of the GLBA and all implementing regulations as they become effective.

### **USA Patriot Act**

As part of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ( USA Patriot Act ), signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ( IMLAFATA ). IMLAFATA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, or other financial institutions. These measures may include enhanced record keeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions. Covered financial institutions also are barred from dealing with foreign shell banks. In addition, IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Treasury regulations implementing the due diligence requirements must be issued no later than April 24, 2002. Whether or not regulations are adopted, the law becomes effective July 23, 2002. Additional regulations are to be adopted during 2002 to implement minimum standards to verify customer identity, to encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, to prohibit the anonymous use of concentration accounts, and to require all covered financial institutions to have in place a Bank Secrecy Act compliance program. IMLAFATA also amends the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

Kerman State Bank has in place a Bank Secrecy Act compliance program, and it engages in very few transactions of any kind with foreign financial institutions or foreign persons.

### **Consumer protection laws and regulations**

Bank regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and

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insured institutions have been advised to monitor carefully compliance with various consumer protection laws and their implementing regulations. Kerman State Bank is subject to many federal consumer protection statutes and regulations, including the CRA, the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Housing Act, the Home Mortgage Disclosure Act and the Real Estate Settlement Procedures Act. Penalties under these laws may include fines, reimbursements and other penalties. Due to heightened regulatory concern related to compliance with these and other statutes generally, Kerman State Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

### **Other legislation**

Other legislation has been or may be proposed to the United States Congress and the California Legislature and regulations which may be proposed by the FDIC, the DFI and the Federal Reserve may affect the business of the Bank. It cannot be predicted whether any pending or proposed legislation or regulations will be adopted or the effect such legislation or regulations may have upon the business of the Bank.

### **Other information**

Kerman State Bank holds no material patents, trademarks, licenses, franchises or concessions. No expenditures have been made by the Bank, during the last two fiscal years, on material research activities relating to the development of services or the improvement of existing services.

Based upon present business activities, compliance with federal, state and local provisions regulating discharge of materials into the environment will have no material effects upon the capital expenditures, earnings and competitive position of the Bank.

Kerman State Bank employed 47 full-time employees and six part-time employees as of December 31, 2001.

Kerman State Bank's business is related to the agricultural seasons and cycles. Kerman State Bank intends to continue with the same basic commercial banking activities that have characterized Kerman State Bank's operations since its inception.

### **Premises**

Kerman State Bank maintains a headquarters banking office located at 306 South Madera Avenue, Kerman, California and branches located at 5751 South Elm Street, Easton California and 1312 P Street, Firebaugh, California. An administrative office is located at 426 South Madera Avenue in Kerman, California.

The Kerman State Bank's main office is owned and consists of a two-story facility. This is a full service office providing products and services for deposit customers with walk-up, drive-up and ATM services. Safe deposit boxes are available for rent. It also houses loan officers who attend to the customer's loan related needs.

The administrative building provides an area for employees who perform non-customer contact functions and services. This includes internal accounting and auditing functions.

The Easton office is leased on a month to month basis. It is a full service facility including deposits, loans and ATM services.

The Firebaugh office building is owned, but the land is leased. This is also a full service office, accommodating deposits, loans and has an ATM for automated transactions.

### **Legal Proceedings**

In the normal course of business, Kerman State Bank is occasionally made a party to actions seeking to recover damages from the Bank. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on Kerman State Bank's financial condition.



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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS OF KERMAN STATE BANK**

Certain matters discussed or incorporated by reference in this proxy statement/ prospectus are forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forwarded-looking statements. Such risks and uncertainties include, but are not limited to; those described in Information about Kerman State Bank. Therefore, the information set forth therein should be carefully considered when evaluating the business prospects of Kerman State Bank.

Management's discussion and analysis of financial condition and results of operations is designed to provide a better understanding of significant trends relating to Kerman State Bank's financial condition, results of operations, liquidity and capital resources as reflected in the financial statements as of and for the years ended December 31, 2001 and 2000. This analysis and the accompanying selected statistical information should be read in conjunction with the financial statements and notes thereto included in this Proxy Statement/ Prospectus.

**RESULT OF OPERATIONS**

**Summary**

For the year ended December 31, 2001, Kerman State Bank reported net income of \$981,000 or \$0.69 per share (basic and diluted) as compared to \$989,000 or \$.68 per share (basic and diluted) for the year ended December 31, 2000. Kerman State Bank's net interest income was \$4,805,000 for 2001 as compared to \$5,144,000 in 2000. However, the decrease in net interest income was offset by a decrease in the provision for loan losses of \$295,000. Other income and expense increased \$64,000 and \$37,000 or 6.9% and 0.9%, respectively.

Total assets at December 31, 2001 were \$105.3 million, representing a 7.5% decrease over total assets of \$113.8 million at December 31, 2000. This decrease was primarily due to the decrease in the net loan portfolio of \$12.7 million and a decrease in securities of \$4.4 million, which were offset by an increase in cash and cash equivalents of \$8.3 million. The delay in setting a price for the 2000 raisin crop prevented the annual raisin production loans from being paid off, resulting in a greater than normal portfolio balance at the year ended 2000.

Total deposits at December 31, 2001 were \$92.9 million representing an 8.6% decrease in overall deposits from \$101.6 million at December 31, 2000. The net decrease in interest bearing deposits of \$6.4 was primarily due to the raisin industry not settling on a price at the end of 2000. This event reduced the usual amount of annual deposits from crop proceeds. Likewise, without payments for the delivered raisins, borrowers withdrew funds to use for cultural costs associated with the upcoming production year.

Kerman State Bank's primary capital resource is shareholders' equity, which increased \$841,000 in 2001 which is a result of net income of \$981,000, unrealized gain on securities of \$104,000 less the repurchase of 33,411 shares for \$244,000.

For the year ended December 31, 2000, Kerman State Bank reported net income of \$989,000 or \$0.68 per share (basic and diluted). Net income increased \$70,000 in 2000, representing an increase 7.6% from the net income of \$919,000 in 1999. Total assets at December 31, 2000 were \$113.8 million, representing a 7.0% increase over total assets of \$106.3 million at December 31, 1999. This increase was primarily due to an increase in net loans of \$11.2 million.

Total deposits at December 31, 2000 were \$101.6 million representing a 6.1% increase in overall deposits of \$95.7 million at December 31, 1999.

**Net interest income**

Interest income represents interest earned by Kerman State Bank on its portfolio of loans and investment securities. Interest expense represents interest paid to Kerman State Bank depositors, and on borrowings from

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the Federal Home Loan Bank, as well as the temporary borrowings of Fed Funds on an occasional overnight basis. Net interest income is the difference between interest income and fees derived from loans and other earning assets and the interest paid on deposits and other interest-bearing liabilities. The volume of loans and deposits and interest-rate fluctuations resulting from various economic conditions may significantly affect net interest income.

Net interest income of \$4.8 million in 2001 decreased by 6.6% from net interest income of \$5.1 million in 2000. The prime rate at the beginning of 2001 was 9.5% and after eleven rate cuts during the year the prime rate at December 31, 2001 was 4.75%. Total interest income and total interest expense in 2001 decreased \$2.1 million and \$1.7 million or 22% and 39%, respectively. The primary cause for the decrease was the reduction in the prime rate as discussed earlier and the absence of 2001 borrowings from the FHLB for peak season loan demand.

Net interest income in 2000 increased by 11.4% from net interest income of \$4.6 million in 1999 to \$5.1 million in 2000, primarily due to the late settlement of a final raisin price for the 2000-year crop and an increase in the prime rate during 2000. Interest expense in 2000 increased \$1.3 million. This increase was due to increased customer deposits and borrowings from the FHLB to supplement the peak season agricultural loan demand.

**Table of Contents****Distribution of average assets, liabilities, and shareholders equity:****interest rates and interest differential**

The following table sets forth average daily balances of assets, liabilities, and shareholders equity during 2001 and 2000 along with total interest income earned and expense paid, and the average yields earned or rates paid thereon and the net interest margin for the years ended December 31, 2001 and 2000.

	December 31, 2001			December 31, 2000			December 31, 1999		
	Average Balance	Income/Expense	Average Yield/Rate	Average Balance	Income/Expense	Average Yield/Rate	Average Balance	Income/Expense	Average Yield/Rate
Loans(1)(2)	\$ 68,844	\$6,115	8.88%	\$ 70,610	\$7,500	10.62%	\$ 63,698	\$6,175	9.69%
Investment securities:									
Taxable	15,748	956	6.07%	22,402	1,489	6.65%	18,703	1,084	5.80%
Non-taxable(3)	1,421	72	5.07%	1,666	80	4.80%	1,856	106	5.71%
Total loans and investment securities	86,013	7,143	8.30%	94,678	9,069	9.58%	84,257	7,365	8.74%
Due from banks, time	134	8	5.97%	194	12	6.19%	294	17	5.78%
Federal funds sold	8,634	344	3.98%	8,019	492	6.14%	8,634	360	4.17%
Total earning assets	\$ 94,781	\$7,495	7.91%	\$ 102,891	\$9,573	9.30%	\$ 93,185	\$7,742	8.31%
Cash and due from banks	6,230			6,408			6,244		
Allowance for loan losses	(1,351)			(1,197)			(1,310)		
Premises and equipment, net	840			860			2,453		
Accrued interest receivable and other assets	5,350			5,440			2,816		
Total assets	\$ 105,850			\$ 114,402			\$ 103,388		
Liabilities and shareholders equity									
Deposits:									
Interest bearing									
demand	\$ 13,562	\$ 213	1.57%	\$ 14,756	\$ 261	1.77%	\$ 15,609	\$ 268	1.72%
Savings	5,041	90	1.79%	5,303	111	2.09%	4,765	99	2.08%
Time	59,576	2,387	4.01%	61,793	3,717	6.02%	56,161	2,704	4.81%
Total deposits	78,179	2,690	3.44%	81,852	4,089	5.00%	76,535	3,071	4.01%
Borrowings				4,986	340	6.82%	968	56	5.79%
Total interest bearing liabilities	\$ 78,179	\$2,690	3.44%	\$ 86,838	\$4,429	5.10%	\$ 77,503	\$3,127	4.03%
Noninterest bearing									
DDA	15,561			16,171			15,836		
Accrued interest payable and other liabilities	1,046			550			489		
Shareholders equity	11,064			10,843			9,560		



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Total liabilities and Shareholders' equity	\$105,850	\$114,402	\$103,388
Net interest income	\$4,805	\$5,144	\$4,615
Net interest income to Average earning assets (Net Interest Margin(4))	5.07%	5.00%	4.95%

- (1) Average loans include nonaccrual loans.
- (2) Loan interest income includes loan fee income of \$250,000 in 2001 and \$204,000 in 2000.
- (3) Applicable nontaxable securities yields have not been calculated on a tax-equivalent basis because they are not material to Kerman State Bank's results of operations.
- (4) Net interest margin is calculated by dividing net interest income by the average balance of total earning assets for the applicable year.

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As shown in Table 1, Kerman State Bank's net interest margin for 2001 increased to 5.07% at December 31, 2001 from 5.00% at December 31, 2000, an increase of 7 basis points due to an increase of fixed rate loans which were initiated in 1999. This allowed Kerman State Bank to earn a greater return in 2001 as interest expense was lower in 2001 because of the market rate decreases in 2001.

The net interest margin for 2000 was 5 basis points higher than the net interest margin of 4.95% in 1999. This was the direct result of the raisin industry not settling on a price for the 2000 raisin crop. Since growers did not receive proceeds from their delivered crop, these raisin related financed credits remained opened through year end, thus generating a greater amount of interest income than normal.

**Rate and volume analysis**

The following table sets forth a summary of the changes in interest earned and interest paid in December 31, 2001 over 2000, and December 31, 2000 over 1999. The change resulting from growth in each asset or liability category is expressed as a volume change and changes resulting primarily from changes in rates is expressed as a rate change. The change in interest due to both rate and volume has been allocated in proportion to the relationship of absolute dollar amounts of change in each.

	2001 Over 2000			2000 Over 1999		
	Volume	Rate	Total	Volume	Rate	Total
(Dollars in 000s)						
<b>Increase (decrease) In Interest and Fee Income</b>						
Time Deposits With Other Financial Institutions	\$ (4)	\$ 0	\$ (4)	\$ (6)	\$ 1	\$ (5)
<b>Investment securities:</b>						
Taxable	(413)	(120)	(533)	229	176	405
Non-taxable	(12)	4	(8)	(11)	(15)	(26)
Federal funds sold	35	(183)	(148)	(27)	159	132
Loans	(184)	(1,201)	(1,385)	685	640	1,325
Total interest and fee income	(578)	(1,500)	(2,078)	870	961	1,831
<b>Increase (Decrease) In Interest Expense</b>						
<b>Deposits:</b>						
Interest bearing transaction accounts	(20)	(28)	(48)	(14)	7	(7)
Savings	(5)	(16)	(21)	12		12
Time deposits	(129)	(1,201)	(1,330)	356	657	1,013
Total deposits	(154)	(1,245)	(1,399)	354	664	1,018
Borrowings	(170)	(170)	(340)	233	51	284
Total interest expense	(324)	(1,415)	(1,739)	587	715	1,302
Net interest income	\$ (254)	\$ (85)	\$ (339)	\$ 283	\$ 246	\$ 529

During 2001, total interest income decreased \$2.1 million or 21% as compared to 2000. Of this decrease, \$1.5 million or 72% was related to the drop in interest rates and \$578,000 or 28% was related to a decrease in interest earning assets.

During 2001, total interest expense decreased \$1.7 million or 39% as compared to 2000. Of this decrease, \$1.4 million or 81% was related to the drop in interest rates and \$324,000 or 19% was related to a decline in customer deposits and borrowings from the Federal Home Loan Bank.

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During 2000, total interest income increased \$1.8 million or 23% as compared to 1999. Of this increase, \$870,000 or 48% was related to the increase in volume of average earning assets in 2000 as compared to 1999 and \$961,000 or 52% was related to interest rates.

During 2000, total interest expense increased \$1.3 million or 42% from 1999. Of this increase, \$587,000 or 45% was related to the volume of average interest-bearing deposits and borrowings in 2000 compared to 1999 and \$715,000 or 55% was related to interest rates.

**Non-interest income**

Non-interest income consists primarily of service charges and other fees earned on services provided to Kerman State Bank's customers. Total non-interest income for the year ended December 31, 2001 was \$998,000, an increase of \$64,000 and 7% compared to the same period in 2000. The increase was primarily the result of increased fees collected from customers for services charges and NSF charges, which totaled \$752,000 in 2001. This represents an increase of \$87,000 and 13% greater from 2000.

Non-interest income was \$934,000 for the year ended December 31, 2000, which was \$74,000 or 9% greater than the same period in 1999. The increase was primarily the result of increased fees collected from service charges and NSF charges of \$665,000 in 1999. This represents an increase of \$81,000 or 14% from 1999.

**Non-interest expense**

Non-interest expense was \$4,005,000 for the year ended December 31, 2001, which was \$37,000 or 0.9% greater than the same period in 2000. The increase was primarily due to salaries and wages increasing \$226,000 or 15.8% in 2001. Personnel were added to accommodate increased supervision and restructuring of the loan production process and related functions along with the payment of a \$60,000 bonus to loan department employees for meeting specific year-end loan goals. The increase in salaries and wages was offset by a decrease in other real estate expenses of \$262,000 or 44% in 2001 compared to 2000. Other operating expenses were up \$133,000 for the year ended December 31, 2001 or 20% primarily due to an increase of \$30,000 in legal and professional fees associated with merger activities, \$31,000 for stationery and supplies and \$75,000 for other miscellaneous expenses. The increase in miscellaneous expenses was due to a \$45,000 settlement for a life insurance policy on the former CEO, an increase in FRB service charges and fuel surcharge increase for armored car services.

Non-interest expense for 2000 was \$3,968,000 which was \$409,000 or 11% greater than the same period in 1999. Of this amount, \$386,000 was the result of a write-down of foreclosed assets to estimated fair value. These assets were purchased to protect Kerman State Bank's security interest on a nonperforming loan.

**Investment portfolio**

The following tables show the book value of investment securities as of December 31, 2001, 2000, and December 31, 1999, and a summary of the maturities and weighted average yields of investment securities as of December 31, 2001.

**Carrying Value as of December 31:**

	Available-for-Sale		
	2001	2000	1999
		(In 000s)	
Securities of the U. S. Treasury and government agencies	\$ 15,400	\$ 19,680	\$ 22,182
Municipal securities	1,425	1,520	1,719
	<u>          </u>	<u>          </u>	<u>          </u>
Total	\$ 16,825	\$ 21,200	\$ 23,901
	<u>          </u>	<u>          </u>	<u>          </u>

**Table of Contents****Maturity and Weighted Average Yield of Investment Securities**

as of December 31, 2001

	In One Year or Less		After One through Five Years		After Five through Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
(Dollars in 000s)										
Available for sale securities:										
Securities of the US Treasury and other US government agencies	\$2,521	7.08%	\$1,000	7.25%			\$11,879	5.97%	\$15,400	6.03%
Municipal securities(1)	254	6.49%	529	5.80%	\$642	7.10%			1,425	6.46%
<b>Total</b>	<b>\$2,775</b>	<b>7.03%</b>	<b>\$1,529</b>	<b>6.75%</b>	<b>\$642</b>	<b>7.10%</b>	<b>\$11,879</b>	<b>5.97%</b>	<b>\$16,825</b>	<b>6.20%</b>

(1) Yields shown are not computed on a tax equivalent basis.

Investment securities decreased \$4.4 million or 20% at December 31, 2001 compared to December 31, 2000. The decrease was the result of issuers exercising their rights to call these securities due to the decrease in market interest rates.

Investment securities decreased \$2.7 million or 11% at December 31, 2000 compared to December 31, 1999. The decrease was due to Kerman State Bank using the proceeds from sales and maturities during the year to help fund loan growth and demand.

**Loan portfolio**

The composition of the loan portfolio as of December 31, 2001 and 2000 is summarized in the table below.

	2001	2000
(In 000s)		
Agricultural loans	\$28,537	\$34,317
Commercial loans	12,556	12,436
Real estate loans mortgage loans	21,275	27,388
Installment loans	1,853	2,783
LESS:		
Deferred loan fees and costs	7	18
Allowance for loan losses	1,298	1,260
<b>Total</b>	<b>\$62,916</b>	<b>\$75,646</b>

**Agricultural loans**

Agricultural loans are extensions of credit to provide operating funds, injections of capital, purchases of equipment or other purposes relating to the production and harvest of farm crops, livestock, dairy and/or other agricultural related needs. The collateral held by Kerman State Bank for these loans is generally crops, equipment and real estate. These credits generally mature within one year.

**Commercial loans**

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Commercial loans are credits made for funding a business need of a retail, wholesale, service, professional, manufacturing, municipality or other government agency or business. The funds are generally used for operating expenses, purchasing inventory, and carrying accounts receivable and working capital.

**Table of Contents****Real estate mortgage loans**

Real estate loans are those loans made to provide funding for land purchases and development, construction or purchase of residential, business, industrial or other real property. The collateral held by Kerman State Bank for these types of loans is generally the related real estate. The typical terms of these loans are to either to fully amortize within fifteen to thirty years or payments due over five years with a balloon at balloon at maturity. Construction loans are usually extended for a period of six months.

**Installment loans**

Installment loans are consumer credits made for the various needs of the individual consumer. They may include the purchase of personal transportation or recreational vehicles, personal lines of credit, home equity loans or lines and unsecured loans for personal purposes. These loans generally mature within one year to five years. The collateral taken by Kerman State Bank is usually the purchase being financed.

**Loan maturities and sensitivity to changes in interest rates**

The following table shows maturity distribution of loans and sensitivity in interest rates as of December 31, 2001.

	In One Year or Less	After One through Five Years	After Five Years	Total
(In 000s)				
Agricultural loans	\$22,270	\$ 6,145	\$ 122	\$28,537
Commercial loans	7,336	4,472	748	12,556
Real estate loans mortgage loans	5,066	15,223	986	21,275
Installment loans	539	968	346	1,853
<b>Total</b>	<b>\$35,211</b>	<b>\$26,808</b>	<b>\$2,202</b>	<b>\$64,221</b>
Loans with fixed interest rates	\$ 4,892	\$14,445	\$ 542	\$19,879
Loans with floating interest rates	30,319	12,363	1,660	\$44,342
<b>Total</b>	<b>\$35,211</b>	<b>\$26,808</b>	<b>\$2,202</b>	<b>\$64,221</b>

**Provision for loan losses**

The provision for loan losses corresponds to the level of the allowance for loan losses that management deems adequate to provide for probable losses in the portfolio. The balance in the allowance for loan loss reflects the amount which, in management's judgment, is adequate to provide for these probable losses after weighting the mix of the loan portfolio, current economic conditions, past loan experience and such other factors as deserve recognition in estimating loan losses.

Management allocated \$295,000 as a provision for loan losses in 2001 compared to \$590,000 in 2000. The reduction of \$295,000 in the provision from 2001 and 2000 was primarily the result of the changes in the level of charged off loans, which totaled \$312,000 in 2001 compared to \$746,000 in 2000. Although the level of classified assets at the beginning of 2001 increased, measures were taken to cure a majority of the classified items before year-end.

Kerman State Bank establishes the total amount of its allowance for loan losses by considering a variety of factors. Management establishes a risk rating for each loan based upon an analysis of customary underwriting criteria. An allowance is allocated on a percentage basis for the total loan volume for each risk-rating category. For individual loans that are considered as substandard quality, a through analysis is performed on each identified loan and a specific loan loss allocation is assigned primarily based on an estimate of the fair market valuation of collateral held as security for loan repayment.



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In addition to the above factors, Kerman State Bank considers and allocates reserves based on any portfolio lending concentrations, trends in delinquency, local and regional economic factors, interest rate environment and certain special considerations that may currently exist. This process is completed at least quarterly. After calculating the total amount of allocation necessary, additions to Kerman State Bank's allowance for loan loss are funded if required.

Kerman State Bank does not allocate its allowance for loan losses among loan categories.

**Summary of loan loss experience**

As a natural corollary to Kerman State Bank's lending activities, some loan losses are experienced. The risk of loss varies with the type of loan being made and the creditworthiness of the borrower over the term of the loan. To some extent, the degree of perceived risk is taken into account in establishing the structure of, and interest rates and security for, specific loans and for various types of loans. Kerman State Bank attempts to minimize its credit risk exposure by use of thorough loan application and approval procedures.

Kerman State Bank maintains a program to systematically review its existing loan portfolio. Loans are graded based on their overall quality. Those loans which management determines require further monitoring and supervision are segregated and reviewed on a periodic basis. Loans for which it is probable that all amounts due (including principal and interest) will not be collected according to the contractual terms of the loan agreement are considered to be impaired. In addition, when principal or interest on a loan is past due 90 days or more, such loan is placed on non-accrual status unless the loan is both well secured and in the process of collection. Loans that are placed on non-accrual status are considered impaired. The recorded investment in impaired loans totaled \$2.6 million at December 31, 2001 and \$2.9 million at December 31, 2000. If these loans had been performing as agreed, interest income of \$287,000 and \$365,000 would have been recognized for 2001 and 2000, respectively.

Kerman State Bank charges off that portion of any loan which management or bank examiners consider representing a loss. A loan is generally considered by management to represent a loss in whole or in part when an exposure beyond any collateral value is apparent, servicing of the unsecured portion has been discontinued or collection is not anticipated based on the borrower's financial condition and general economic conditions in the borrower's industry. The principal amount of any loan classified as a loss is charged against Kerman State Bank's allowance for loan losses.



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The following table provides a summary of Kerman State Bank's loan loss experience as of December 31, 2001, and 2000.

	December 31,	
	2001	2000
	(Dollars in 000s)	
Average loans for the period	\$ 68,844	\$ 70,610
Loans outstanding at end of period	64,221	76,924
<b>Allowance for Loan Losses</b>		
Balance, beginning of period	1,260	1,415
Less loans charged off:		
Real estate loans	212	342
Commercial loans	27	362
Installment loans	73	42
Total loans charged off	312	746
Recoveries:		
Real estate loans	0	0
Commercial loans	20	0
Installment loans	35	1
Total recoveries	55	1
Net loans charged off	257	745
Provision for loan losses	295	590
Balance, end of period	\$ 1,298	\$ 1,260
Net loans charged off to average loans by types:		
Real estate loans	.89%	