First California Financial Group, Inc.
Form 10-Q
August 13, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**38-3737811**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
1880 Century Park East, Suite 800	
Los Angeles, California	**90067**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (310) 277-2265

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

11,715,185 shares of Common Stock, $0.01 par value, as of August 6, 2007

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FIRST CALIFORNIA FINANCIAL GROUP, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended June 30, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Condensed consolidated balance sheets (unaudited)

(in thousands)	**June 30, 2007**	**December 31, 2006**
Cash and due from banks	$ 21,219	$ 13,438
Federal funds sold	2,777	
Securities	173,654	104,414
Loans held for sale	7,256	
Loans, net	722,802	360,978
Premises and equipment, net	18,932	5,725
Goodwill	50,216	3,225
Core deposits and other intangibles	10,256	1,184
Cash surrender value of life insurance	10,722	
Accrued interest receivable and other assets	15,948	12,599
Total assets	$ 1,033,782	$ 501,563
Non-interest checking	$ 219,562	$ 115,745
Interest checking	41,303	26,372
Money market	188,216	118,704
Savings	51,791	22,463
Certificates of deposit, under $100,000	89,021	17,250
Certificates of deposit, $100,000 and over	186,694	80,080
Total deposits	776,587	380,614
Borrowings	86,721	55,300
Junior subordinated debentures	26,622	15,464
Accrued interest payable and other liabilities	12,643	5,116
Total liabilities	902,573	456,494
Total shareholders equity	131,209	45,069
Total liabilities and shareholders equity	$ 1,033,782	$ 501,563

See accompanying notes.

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FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Condensed consolidated statements of operations (unaudited)

(in thousands, except per share data)	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Interest and fees on loans	$ 15,875	$ 7,551	$ 26,194	$ 14,591
Interest on securities	2,209	1,319	3,886	2,304
Interest on federal funds sold and interest bearing deposits	69	43	120	69
Total interest income	18,153	8,913	30,200	16,964
Interest on deposits	4,598	2,044	7,945	3,614
Interest on borrowings	1,406	506	2,493	875
Interest on junior subordinated debentures	439	397	798	793
Total interest expense	6,443	2,947	11,236	5,282
Net interest income	11,710	5,966	18,964	11,682
Provision for loan losses		40		72
Net interest income after provision for loan losses	11,710	5,926	18,964	11,610
Service charges on deposit accounts	480	234	750	466
Loan sales and commissions	816		1,074	
Gain on sale of bank charters	2,375		2,375	
Trading losses on non-hedge derivatives		(369)		(817)
Other income	344	59	421	192
Total noninterest income (loss)	4,015	(76)	4,620	(159)
Salaries and employee benefits	5,438	2,193	8,695	4,282
Premises and equipment	954	394	1,644	788
Loss on early termination of debt			1,564	
Integration and conversion expenses	1,427		4,903	
Other expenses	2,055	1,232	3,419	2,481
Total noninterest expense	9,874	3,819	20,225	7,551
Income before provision for income taxes	5,851	2,031	3,359	3,900
Provision for income taxes	2,741	885	1,344	1,698
Net income	$ 3,110	$ 1,146	$ 2,015	$ 2,202
Earnings per share				
Basic	$ 0.27	$ 0.21	$ 0.22	$ 0.40
Diluted	$ 0.25	$ 0.19	$ 0.20	$ 0.37

See accompanying notes.

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Consolidated statements of cash flows (unaudited)

(in thousands)	Six Months Ended June 30, 2007	2006
Net income	$ 2,015	$ 2,202
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	489	239
Provision for credit losses		72
Trading loss on non-hedge derivatives		817
Stock-based compensation costs	54	185
Accretion of discounts on securities available-for-sale	(193)	(104)
Amortization of premiums on securities held-to-maturity		10
Amortization of core deposit intangibles	282	112
Amortization of premium on loans purchased	30	64
Loss (gain) on sale of other real estate owned	142	(48)
Gain on sale of bank charters	(2,375)	
Origination of loans held for sale	(32,180)	
Proceeds from sale and payments received from loans held for sale	46,212	
Increase in cash surrender value of life insurance	(112)	
Increase in accrued interest receivable and other assets	(1,652)	(391)
Decrease in accrued interest payable and other liabilities	3,302	3,897
Net cash provided by operating activities	16,014	7,055
Purchases of securities available-for-sale	(3,115)	(48,055)
Proceeds from repayment and maturities of securities available-for-sale	15,096	16,011
Proceeds from repayment and maturities of securities held-to-maturity		333
Proceeds from sale of Federal Home Loan Bank stock	1,323	
Purchases of Federal Home Loan Bank stock		(336)
Net change in federal funds sold	(1,995)	
Loan originations and principal collections, net	(17,349)	(12,736)
Proceeds received for sale of Bank charters	2,375	
Purchases of premises and equipment	(296)	(280)
Proceeds from sale of other real estate owned		1,104
Net cash and cash equivalents received in acquisition	6,760	
Net cash provided by (used in) investing activities	2,799	(43,959)
Net increase in demand deposits, money market and savings accounts	21,725	11,820
Net decrease in time certificates of deposit	(20,552)	(2,452)
Net increase (decrease) in securities sold under agreement to repurchase and federal funds purchased	(2,936)	45,000
Net decrease in other borrowings	(10,300)	(16,087)
Issuance of junior subordinated debentures	16,495	
Redemption of junior subordinated debentures	(15,464)	
Proceeds from exercise of stock options		296
Redemption of fractional shares in 5-for-4 stock split		(1)
Net cash provided by (used in) financing activities	(11,032)	38,576
Change in cash and due from banks	$ 7,781	$ 1,672
Cash and due from banks, beginning of period	13,438	16,192

Cash and due from banks, end of period	$ 21,219	$ 17,864
Supplemental cash flow information:		
Cash paid for interest	$ 11,226	$ 4,324
Cash paid for income taxes	$ 92	$ 730
Supplemental disclosure of noncash investing activities:		
Issuance of common stock for purchase accounting merger	$ 82,982	$
Unrealized gain (loss) on securities available-for-sale, net of tax effect	$ (1,641)	$ 1,290
Unrealized gain (loss) on cash flow hedges, net of tax effect	$ 142	$ (519)

See accompanying notes.

NOTE 1 BASIS OF PRESENTATION

Organization and nature of operations First California Financial Group, Inc., or First California or the Company, was incorporated under the laws of the State of Delaware on June 7, 2006. The Company was formed as a wholly-owned subsidiary of National Mercantile Bancorp, a California corporation, or National Mercantile, for the purposes of effecting the merger and capital stock exchange with National Mercantile and acquisition of FCB Bancorp, a California corporation, or FCB.

On June 15, 2006, First California, FCB and National Mercantile entered into an Agreement and Plan of Merger, or the Merger Agreement, providing for the merger of National Mercantile with and into the newly formed holding company, First California, and the conversion of each share of National Mercantile common stock into the right to receive one share of First California common stock and the conversion of each share of FCB common stock into the right to receive 1.7904 shares of First California common stock. In addition, the Merger Agreement provided for the conversion of each share of National Mercantile series B convertible perpetual preferred stock into the right to receive one share of series A convertible perpetual preferred stock, $0.01 par value per share, or First California Preferred Stock, of First California. The merger and acquisition were approved by both National Mercantile and FCB shareholders and regulators.

On March 12, 2007, First California completed the merger and capital stock exchange with National Mercantile and acquisition of FCB pursuant to the Merger Agreement as described above. Concurrent with the merger and acquisition, the number of common shares authorized of First California was increased to 25,000,000 shares and First California authorized the issuance of 2,500,000 shares of preferred stock of which 1,000 shares were designated as series A convertible perpetual preferred stock. In addition, each share of National Mercantile series B convertible perpetual preferred stock was exchanged for one share of series A convertible perpetual preferred stock of First California. As a result of these transactions, First California issued an aggregate of approximately 11.5 million shares of First California common stock to former National Mercantile and FCB shareholders and 1,000 shares of First California preferred stock to former shareholders of National Mercantile series B convertible preferred stock. First California paid cash in lieu of fractional shares of First California common stock issued in connection with the acquisition of FCB.

Upon completion of the merger of National Mercantile into its wholly-owned subsidiary First California and the acquisition of FCB by First California, the separate corporate existence of National Mercantile and FCB ceased, and First California succeeded and assumed all the rights and obligations of National Mercantile and FCB. First California assumed all rights and obligations of National Mercantile, whose principal assets were the capital stock of two bank subsidiaries: Mercantile National Bank, or Mercantile, and South Bay Bank, N.A., or South Bay. As a result of the acquisition of FCB, First California acquired all the rights and obligations of FCB, whose principal assets consisted of the capital stock of First California Bank. As contemplated by the Merger Agreement, First California Bank purchased substantially all the assets and assumed substantially all the liabilities of Mercantile and South Bay, sold the bank charters of Mercantile and South Bay to United Central Bank and The Independent BankersBank and recognized a gain of $2.4 million during the second quarter of 2007. First California Bank provides a broad range of banking products and services, including credit, cash management and deposit services through twelve full service banking offices located in Southern California.

Consolidation The accompanying condensed consolidated financial statements include, in conformity with generally accepted accounting principles, the accounts of the Company and its bank subsidiaries but excludes the accounts of FCB Statutory Trust I and First California Statutory Trust I. Results of operations for the six months ended June 30, 2007 includes operations of FCB from the date of acquisition. The Company s historical balance sheet and results of operations before the mergers are the same as the historical information of National Mercantile. All material intercompany transactions have been eliminated.

Basis of presentation The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, all normal recurring adjustments necessary for a fair presentation are reflected in the unaudited condensed consolidated financial statements. Operating results for the period ended June 30, 2007 are not necessarily indicative of the results for the full year. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s and National Mercantile s 2006 Annual Reports on Form 10-K and Form 10-KSB, respectively.

Management s estimates and assumptions The preparation of the condensed consolidated financial statements, in conformity with generally accepted accounting principles, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by us primarily involve the calculation of the allowance for loan losses, the carrying amount of deferred tax assets and goodwill and the effectiveness of derivative instruments in offsetting changes in fair value or cash flows of hedged items.

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Allowance for loan losses The provisions for credit losses charged to operations reflects our judgment of the adequacy of the allowance for loan losses and are determined through periodic analysis of the loan portfolio, problem loans and consideration of other factors such as the Company s loan loss experience, trends in problem loans, concentrations of credit risk, and economic conditions (particularly Southern California), as well as the results of the Company s ongoing examination process and its regulatory examinations.

The calculation of the adequacy of the allowance for loan losses is based on a variety of factors, including loan classifications, migration trends and underlying cash flow and collateral values. On a periodic basis, management engages an outside loan review firm to review the Company s loan portfolio, risk grade accuracy and the reasonableness of loan evaluations. Annually, this outside loan review firm analyzes the Company s methodology for calculating the allowance for loan losses based on the Company s loss histories and policies. The Company uses a migration analysis as part of its allowance for loan losses evaluation, which is a method by which specific charge-offs are related to the prior life of the same loan compared to the total loan pools in which the loan was graded. This method allows for management to use historical trends that are relative to the Company s portfolio rather than use outside factors that may not take into consideration trends relative to the specific loan portfolio. In addition, this analysis takes into consideration other trends that are qualitative relative to the Company s marketplace, demographic trends, amount and trends in nonperforming assets and concentration factors.

Goodwill and other intangible assets The Company has goodwill, which represents the excess of purchase price over the fair value of net assets acquired primarily as a result of the merger. In accordance with generally accepted accounting principles, goodwill is not amortized and is reviewed for impairment on an annual basis or on an interim basis if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying value. Trade name intangible represents the fair value of the First California Bank name, which is amortized using the straight-line method over a period of ten years. Core deposit intangibles, which represent the fair value of depositor relationships resulting from deposit liabilities assumed in acquisitions, are amortized using the straight-line method over the projected useful lives of the deposits. Core deposit and trade name intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment of goodwill and other intangibles is permanently recognized by writing down the asset to the extent that the carrying value exceeds the estimated fair value.

Income Taxes The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes,* on January 1, 2007. FIN 48 prescribes a comprehensive model and provides guidance for accounting and disclosure for uncertainty in tax provisions and for the recognition and measurement related to the accounting for income taxes. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The adoption of FIN 48 did not have a material effect to our financial statements. We have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our accounting policy is to recognize interest and penalties as a component of income tax expense.

Deferred income tax assets and liabilities are determined based on the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. There was no valuation allowance at June 30, 2007 and December 31, 2006.

Derivative instruments and hedging An estimate of the effectiveness of derivative instruments in off-setting changes in fair value or cash flows of hedged items is required to determine the extent to which earnings are affected. Our hedges were effective at June 30, 2007 and December 31, 2006.

Common Shares The number of shares outstanding of First California common stock was 11.7 million at June 30, 2007 and the number of common shares of our predecessor, National Mercantile, was 5.6 million shares at December 31, 2006. On March 12, 2007, the number of shares of First California common stock outstanding increased by 5.9 million as a result of the merger.

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Recent accounting pronouncements In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 established presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of the company s choice to use fair value on its earnings. SFAS No. 159 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements of other accounting standards, including fair value measurement disclosures in SFAS No. 157. This Statement is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. Management does not expect the adoption of SFAS No. 159 to have a material impact on the consolidated financial statements.

NOTE 2 MERGER

On March 12, 2007, First California completed the acquisition of 100% of the outstanding common stock of FCB pursuant to the Merger Agreement as described in Note 1 above. FCB was the parent company of First California Bank. At the date of acquisition, First California Bank became a wholly-owned subsidiary of the Company. As provided by the Merger Agreement, approximately 3.3 million shares representing the then issued and outstanding shares of common stock of FCB were exchanged for approximately 5.9 million shares of the Company s common stock at a calculated exchange ratio of 1.7904. Upon completion of the acquisition, the former shareholders of FCB have an approximate 49.9% interest in the Company. The fair value of $14.14 for each of the Company s common shares issued to complete the acquisition of FCB on March 12, 2007 was based on the average of the quoted market price per share of National Mercantile s common stock for a period of three days before, the day of and three days after the announcement of the merger on June 15, 2006. In addition, FCB had 160,100 employee stock options outstanding at the acquisition date. On the acquisition date, the Company exchanged the FCB stock options for options to purchase shares of the Company s common stock which resulted in the Company granting a total of 286,643 stock options with a weighted average exercise price of $10.33 per share to former FCB employees and executives. The fair value of the stock options of $1.4 million is included in the purchase price.

Under the purchase method of accounting, the estimated cost of approximately $84.9 million to acquire FCB, including transaction costs, was allocated to the assets acquired and liabilities assumed based on their respective fair values as of the date of acquisition as summarized below (in thousands, except share and per share amounts):

Purchase Price		
Number of shares of Company stock issued for FCB stock	5,868,586	
Price of the Company s stock on the date of Merger Agreement	$ 14.14	
Total stock consideration		$ 82,982
Fair value of FCB s stock options converted to Company stock options at acquisition date		1,408
Less: Fair value of unvested options related to future service periods		(804)
Total common stock issued and stock options assumed		83,586
Direct costs of the acquisition		1,338
Total purchase price and acquisition costs		84,924
Allocation of Purchase Price		
FCB s equity	$ 49,444	
Less: Intangible assets derecognized	(17,152)	
Adjustments to reflect assets acquired and liabilities assumed at fair value:		
Loans	(2,489)	
Core deposit intangibles	5,488	
Other assets	6,983	
Deferred tax liabilities	(3,508)	
Deposits	(624)	
Borrowings	(37)	
Subordinated debt	(200)	
Fair value of net assets acquired		37,905

Estimated goodwill arising from acquisition	$ 47,019

The Company has based the allocation of purchase price above on an estimate of the fair values of the assets acquired and the liabilities assumed. Valuations of certain assets and liabilities of FCB were performed with the assistance of independent valuation consultants. None of the resulting goodwill is expected to be deductible for tax purposes.

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The following information presents the pro forma results of operations for the three months ended June 30, 2006 and six months ended June 30, 2007 and 2006, as though the acquisition had occurred on January 1, 2006. The pro forma data was derived by combining the historical consolidated financial information of FCB and National Mercantile using the purchase method of accounting for business combinations. The pro forma results do not necessarily indicate results that would have been obtained had the acquisition actually occurred on January 1, 2006 or the results that may be achieved in the future.

	Pro forma Results of Operations		
	Three months ended	Six months ended	
(in thousands, except per share data)	**June 30, 2006**	**June 30, 2007**	**June 30, 2006**
Net interest income	$ 12,297	$ 19,504	$ 23,395
Noninterest income	(152)	4,620	270
Noninterest expense	7,962	20,808	15,883
Provision for loan losses	80		265
Income before tax	4,103	3,316	7,517
Income taxes	1,701	1,306	3,045
Net income	$ 2,402	$ 2,010	$ 4,472
Pro forma earnings per share			
Basic	$ 0.21	$ 0.17	$ 0.39
Diluted	$ 0.20	$ 0.16	$ 0.38
Pro forma weighted average shares			
Basic	11,399	11,549	11,399
Diluted	11,920	12,235	11,920

NOTE 3 SECURITIES

The amortized cost and estimated fair values of securities available-for-sale are summarized as follows:

	June 30, 2007			
(in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U.S. Treasury notes	$ 2,102	$ 11	$	$ 2,113
U.S. government agency notes	12,908	2	(31)	12,879
U.S. government agency mortgage-backed securities	102,062	26	(1,706)	100,382
Collateralized mortgage obligations	9,640	33		9,673
Municipal securities	49,411		(804)	48,607
Securities available-for-sale	$ 176,123	$ 72	$ (2,541)	$ 173,654

	December 31, 2006			
(in thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U.S. Treasury notes	$ 599	$	$ (4)	$ 595
U.S. government agency notes	8,985	2	(65)	8,922

U.S. government agency mortgage-backed securities	58,067	108	(607)	57,568
Collateralized mortgage obligations	6,417	41	(8)	6,450
Municipal securities	28,991	153	(252)	28,892
Securities available-for-sale	$ 103,059	$ 304	$ (936)	$ 102,427

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At June 30, 2007, there were no securities held-to-maturity. At December 31, 2006, securities-held-to-maturity at amortized cost was $1,987 with an aggregate fair value of $1,947. Gross unrealized losses on securities held-to-maturity was $40 at December 31, 2006. Securities held-to-maturity was comprised of FHLMC/FNMA-issued mortgage pass-through certificates.

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans consist of the following:

(in thousands)	At June 30, 2007	At December 31, 2006
Commercial mortgage	$ 299,300	$ 140,636
Construction and land development	166,091	83,188
Commercial loans and lines of credit	155,644	105,862
Multifamily mortgage	36,029	17,602
Home mortgage	34,204	8,790
Home equity loans and lines of credit	23,594	
Installment & credit card	16,236	9,640
Total loans	731,098	365,718
Allowance for loan losses	(8,296)	(4,740)
Loans, net	$ 722,802	$ 360,978
Loans held for sale	$ 7,256	$

At June 30, 2007, loans held for sale were $7.3 million and consist of commercial and multifamily mortgages originated for sale into the secondary market as well as SBA 7(a) loans, the government guaranteed portion of which will be sold into the secondary market. Loans held for sale are carried at the lower of aggregate cost or market value. Loan sale gains or losses are recorded in noninterest income based on the difference between loan sale proceeds and carrying value.

Most of the Company s lending activity is with customers located in Ventura, Orange and Los Angeles Counties. The Company has no significant credit exposure to any individual customer; however, the economic condition in Southern California could adversely affect customers. A significant portion of our loans are collateralized by real estate. Changes in the economic condition in Southern California could adversely affect the value of real estate.

Changes in the allowance for loan losses were as follows:

	Three Months Ended June 30,		Six Months Ended June, 30	
	2007	2006	2007	2006
	(Dollars in thousands)			
Beginning balance	$ 8,296	$ 4,562	$ 4,740	$ 4,468
Provision for loan losses		40		72
Addition from the merger			3,531	
Loans charged-off	(5)		(6)	(1)
Transfers to undisbursed commitment allowance		46	18	109
Recoveries on loans charged-off	5		13	
Ending balance	$ 8,296	$ 4,648	$ 8,296	$ 4,648
Allowance to loans	1.12%	1.32%	1.12%	1.32%

Nonperforming loans and assets were as follows:

Accruing loans past due 90 days or more	$ 953	$	$ 1,225	$
Nonaccrual loans	$ 5,992	$	$ 5,992	$ 300
Foreclosed assets	$ 161	$	$ 161	$

There were $6.0 million of nonaccrual loans at June 30, 2007.

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NOTE 5 GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill of $50.2 million at June 30, 2007 includes $47.0 million, representing the excess of the purchase price over the fair values of assets acquired and liabilities assumed in the acquisition of FCB. At December 31, 2006, goodwill was $3.2 million. No impairment loss was recognized for the periods ended June 30, 2007 and December 31, 2006.

Core deposit intangibles, net of accumulated amortization, was $6.4 million at June 30, 2007 and $1.2 million at December 31, 2006. Amortization expense for the three months and six months ended June 30, 2007 was $189,000 and $282,000, respectively. Amortization expense for the three months and six months ended June 30, 2006 was $56,000 and $112,000, respectively.

Other intangibles includes trade name, net of accumulated amortization, of $3.9 million, representing the fair value of the First California Bank name recorded as part of the merger. Amortization expense for the three months and six months ended June 30, 2007 was $133,000.

NOTE 6 JUNIOR SUBORDINATED DEBENTURES

In July 2001, the Company issued $15.5 million aggregate principal amount of 10.25% fixed rate junior subordinated deferrable interest debentures due July 25, 2031 (Junior Subordinated Debentures) that paid interest each January 26 and July 26. The Junior Subordinated Debentures were held by National Mercantile Capital Trust I (the Trust), a Delaware business trust, formed by the Company for the sole purpose of issuing certain securities representing undivided beneficial interests in the assets of the Trust and investing the proceeds thereof in the Junior Subordinated Debentures. The Trust Preferred Securities were redeemed and the Junior Subordinated Debentures were repaid in January 2007 from the net proceeds of First California Capital Trust I securities, as described below. The redemption price of the Junior Subordinated Debentures was 107.6875% of the principal amount, plus accrued interest, or a total of $17.3 million. As a result of the redemption, the Company incurred a charge during the first quarter of 2007 of $1.6 million. The charge reflects the redemption premium and the write-off of the unamortized Debenture issuance costs.

On January 24, 2007, the Company and its newly formed subsidiary, First California Capital Trust I (First California Trust), a Delaware statutory trust, issued $16.5 million of the First California Trust s capital securities, liquidation amount $1,000 per capital security. The capital securities represent undivided beneficial interests in the First California Trust s assets, which consist primarily of the Company s Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures described below. The First California Trust s capital securities mature on March 15, 2037, and are redeemable, at par, at the Company s option at any time on or after March 15, 2012.

The holders of the First California Trust s capital securities are entitled to quarterly distributions at a fixed annual rate of 6.80% for the first five years, and a variable annual rate thereafter, which resets quarterly, equal to the 3-month LIBOR rate, plus 1.60% per annum, of the liquidation amount of $1,000 per capital security, subject to the Company s right to defer interest payments under the Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures as described below.

The Company purchased $495,000 of the First California Trust s common securities, liquidation amount $1,000 per common security. In connection with the First California Trust s sale of the capital securities, the Company entered into a Guarantee Agreement pursuant to which it guaranteed, on a subordinated basis, all distributions and payments under the First California Trust s capital securities upon liquidation, redemption, or otherwise, but only to the extent the First California Trust fails to pay such distributions from payments under the Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures it holds from the Company.

The First California Trust used the proceeds from the sale of its capital securities and its common securities to purchase from the Company $16.5 million aggregate principal amount of Fixed/Floating Rate Junior Subordinated Deferrable Interest Debentures due 2037. The Debentures bear interest at the same rates as the First California Trust s capital securities. So long as no event of default (as defined in the Indenture relating to the Debentures) has occurred, First California will have the right to defer the payment of interest on the Debentures for up to 20 consecutive quarterly periods, except that no extension period may extend beyond the maturity of the Debentures. During any deferral period, the Company may not pay dividends or make certain other distributions or payments as provided in the Indenture. The Debentures mature on March 15, 2037, and are redeemable at par, at the Company s option, at any time on or after March 15, 2012. Upon any redemption by the Company of the Debentures, the First California Trust must redeem a like amount of its capital securities.

Payments under the Debentures are subordinated and junior in right of payment to the prior payment of all other indebtedness of the Company that, by its terms, is not similarly subordinated.

The Debentures may be declared immediately due and payable at the election of the trustee under the Indenture or the holders of 25% of aggregate principal amount of the First California Trust s outstanding capital securities if the Company defaults in the payment of interest (subject to its right to defer interest payments as described above) or principal under the Debentures and upon the occurrence of other events of defaults described in the Indenture.

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As a result of the merger, the Company assumed $10,310,000 Junior Subordinated Debentures of FCB, having an estimated fair value of $10,110,000.

NOTE 7 EARNINGS PER SHARE

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if common shares were issued pursuant to the exercise of common stock options under the Company s stock option plans. The following table illustrates the computations of basic and diluted earnings per share for the periods indicated:

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
(in thousands, except per share data)	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic
Income available to common shareholders	$ 3,110	$ 3,110	$ 1,146	$ 1,146	$ 2,015	$ 2,015	$ 2,202	$ 2,202
Basic weighted average common shares outstanding	11,565	11,565	5,542	5,542	9,247	9,247	5,530	5,530
Options	416		251		427		259	
Convertible preferred stock	260		242		259		230	
Net effect of dilutive securities	676		493		686		489	
Diluted weighted average common shares outstanding	12,241	11,565	6,035	5,542	9,933	9,247	6,019	5,530
Earnings per share	$ 0.25	$ 0.27	$ 0.19	$ 0.21	0.20	$ 0.22	$ 0.37	$ 0.40

NOTE 8 COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is the change in equity during a period from transactions and other events and circumstances from nonowner sources. Total comprehensive income (loss) was as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Net income	$ 3,110	$ 1,146	$ 2,015	$ 2,202
Other comprehensive loss before tax, and unrealized losses on securities and derivative instruments:				
Unrealized gain (loss) on interest rate swaps used in cash flow hedges	(209)	(317)	14	(821)
Unrealized loss on interest rate floors used in cash flow hedges	(26)	(24)	(47)	(248)
Unrealized holding losses on securities available-for-sale arising during the period	(3,336)	(1,409)	(3,866)	(2,205)
Less: Reclassification of losses included in net income, net of income tax benefit of $ 18			24	
Other comprehensive loss, before tax	(3,571)	(1,750)	(3,875)	(3,274)
Income tax benefit related to items of other comprehensive income	1,474	705	1,785	1,149
Other comprehensive loss	(2,097)	(1,045)	(2,090)	(2,125)
Total comprehensive income (loss)	$ 1,013	$ 101	$ (75)	$ 77

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

This Quarterly Report on Form 10-Q may contain certain forward-looking statements about the Company and its subsidiaries, which statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are forward-looking statements. Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond the control of the Company. Readers are cautioned that a number of important factors could cause actual results to differ materially from those expressed in, implied or projected by, such forward-looking statements. Risks and uncertainties include, but are not limited to:

- relative cost savings cannot be realized or realized within the expected time frame;
- revenues are lower than expected;
- an increase in the provision for loan losses resulting from credit quality deterioration;
- competitive pressure among depository institutions increases significantly;
- the Company s ability to integrate the operations of Mercantile National Bank, South Bay Bank, N.A., and First California Bank and to achieve expected synergies, operating efficiencies or other benefits within expected time-frames or at all, or within expected cost projections;
- the possibility that personnel changes will not proceed as planned;
- the cost of additional capital is more than expected;
- a change in the interest rate environment reduces interest margins;
- asset/liability repricing risks and liquidity risks;
- general economic conditions, either nationally or in the market areas in which the Company does or anticipates doing business, are less favorable than expected;
- the economic and regulatory effects of the continuing war on terrorism and other events of war, including the war in Iraq;
- legislative or regulatory requirements or changes adversely affect the Company s business; and
- changes in the securities markets.

If one or more of the factors affecting our forward-looking information and statements proves incorrect, then our actual results, performance or achievements could differ materially from those expressed in, or implied or projected by, the forward-looking information and statements contained in this document. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. The forward-looking statements are made as of the date of this document and we do not intend, and assume no obligation, to update the forward-looking statements or to update the reasons why actual results could differ from those expressed in, or implied or projected by, the forward-looking statements. All forward-looking statements contained in this document, and all subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf, are expressly qualified by these cautionary statements.

Critical accounting policies

The discussion and analysis of our consolidated results of operations and financial condition are based upon our unaudited condensed consolidated interim financial statements and our audited consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, income and expense, and the related disclosures of contingent assets and liabilities at the date of these consolidated financial statements. We believe these estimates and assumptions to be reasonably accurate; however, actual results may differ from these estimates under different assumptions or circumstances. The following are our critical accounting policies.

Allowance for loan losses

An estimate of probable losses incurred in the loan portfolio is necessary in determining the amount of the allowance for loan losses which is presented as a reduction of our loan balances. The provision for loan losses, charged to operations, is the amount that is necessary to establish the allowance. The information used by us to make this estimate is described later in this section and in the notes to the consolidated financial statements. The allowance for loan losses was $8,296,000 at June 30, 2007 and $4,740,000 at December 31, 2006.

Income taxes

An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. The information used by us to make this estimate is described later in this section and in the notes to the financial statements. There were no net deferred tax assets at June 30, 2007 and net deferred tax assets of $1,663,000 at December 31, 2006. There was no valuation allowance at June 30, 2007 and December 31, 2006.

Goodwill

An estimate of probable impairment loss is required in determining the carrying value of goodwill. An impairment loss is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. The information used by us to make this estimate is described later in this section and in the notes to the consolidated financial statements. Goodwill was $50,216,000 at June 30, 2007 and was $3,225,000 at December 31, 2006; there was no impairment loss at either period end.

Derivative instruments and hedging

An estimate of the effectiveness of derivative instruments in off-setting changes in fair value or cash flows of hedged items is required to determine the extent to which earnings are affected. Our hedges were effective at June 30, 2007 and December 31, 2006.

Overview

We were a wholly-owned subsidiary of National Mercantile Bancorp, or National Mercantile, formed to facilitate the reincorporation merger with National Mercantile and the merger with FCB Bancorp, or FCB. Accordingly, our historical balance sheet and results of operations before the merger are the same historical information of National Mercantile. We accounted for the FCB merger using the purchase method of accounting; accordingly, our balance sheet includes preliminary estimates of the fair value of the assets acquired and liabilities assumed from FCB. Our results of operations for the six months ended June 30, 2007 include the operations of FCB from the date of acquisition.

For the second quarter of 2007, we had net income of $3.1 million, compared with net income of $1.1 million for the second quarter of 2006. For the six months ended June 30, 2007, we had net income of $2.0 million compared with $2.2 million for the six months ended June 30, 2006. Net income for the six months ended June 30, 2007 included a pre-tax charge of $1.6 million related to a refinancing of trust preferred securities we completed early in the first quarter. The trust preferred refinancing should save us approximately $500,000 per year in pre-tax interest expense. In addition, we completed an integration program among our three banks that combined the banks under a single brand First California Bank. The integration program resulted in pre-tax charges of approximately $3.5 million in the first quarter and $1.4 million in the second quarter of 2007. Also, we sold the remaining two bank charters in the second quarter of 2007 for a gain of $2.4 million.

Our 2007 second quarter net income on a diluted per share basis was $0.25 compared to $0.19 for the same quarter a year ago. Our per share data for 2007 reflect the increase in outstanding weighted average shares that resulted from our issuance of 5.9 million common shares in the merger with FCB Bancorp.

Results of operations for the three and six months ended June 30, 2007 and 2006

Net interest income is the difference between interest and fees earned on loans, securities and federal funds sold (these asset classes are commonly referred to as interest-earning assets) and the interest paid on deposits, borrowings and debentures (these liability classes are commonly referred to as interest-bearing funds). Net interest margin is net interest income expressed as a percentage of average interest-earning assets.

Our net interest income for the second quarter of 2007 was $11.7 million, up 95% from $6.0 million for the same quarter a year ago. Our 2007 second quarter net interest margin (tax equivalent) was 5.14%, compared to 5.26% for the same quarter last year. Net interest income for the first six months of 2007 was $19.0 million, up 62% from $11.7 million for the same period a year ago. Our 2007 year-to-date net interest margin (tax equivalent) was 4.93%, compared to 5.35% for the same period a year ago. The increase in our net interest income reflects the increase in our interest-earning assets from the merger with FCB and from the growth in our lending activities. The decrease in our net interest margin reflects principally the increase in the rates paid for our interest-bearing funds.

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	Three months ended June 30,					
		2007			2006	
(in thousands)	Average Balance	Income / Expense	Average Rate/Yield	Average Balance	Income / Expense	Average Rate/Yield
Loans	$ 733,476	$ 15,875	8.68%	$ 350,878	$ 7,551	8.63%
Securities	178,240	2,209	4.97%	100,419	1,319	5.27%
Federal funds sold	1,299	17	5.25%	1,211	13	4.31%
Deposits with banks	21,085	52	0.99%	2,500	30	4.81%
Total earning assets	934,100	18,153	7.79%	455,008	8,913	7.86%
Non earning assets	69,784			32,364		
Total assets	**$ 1,003,884**	**$ 18,153**		**$ 487,372**	**$ 8,913**	
Interest bearing deposits	$ 544,204	$ 4,598	3.39%	$ 273,139	$ 2,044	3.00%
Borrowings	106,989	1,406	5.27%	39,259	506	5.17%
Junior subordinated debentures	26,747	439	6.58%	15,464	397	10.30%
Total borrowed funds	133,736	1,845	5.53%	54,723	903	6.62%
Total interest bearing funds	677,940	6,443	3.81%	327,862	2,947	3.61%
Noninterest checking	220,093			115,474		
Other liabilities	11,831			4,628		
Shareholders equity	94,020			39,408		
Total liabilities and shareholder s equity	**$ 1,003,884**	**$ 6,443**		**$ 487,372**	**$ 2,947**	
Net interest income		$ 11,710			$ 5,966	
Net interest margin (tax equivalent) [1]			**5.14%**			**5.26%**

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	Six months ended June 30,					
	2007			2006		
(in thousands)	Average Balance	Income / Expense	Average Rate/Yield	Average Balance	Income / Expense	Average Rate/Yield
Loans	$ 615,178	$ 26,194	8.59%	$ 346,831	$ 14,591	8.48%
Securities	155,275	3,886	5.05%	90,409	2,304	5.14%
Federal funds sold	1,271	29	4.60%	829	18	4.38%
Deposits with banks	18,146	91	1.01%	2,103	51	4.89%
Total earning assets	789,870	30,200	7.71%	440,172	16,964	7.77%
Non earning assets	49,236			32,882		
Total assets	**$ 839,106**	**$ 30,200**		**$ 473,054**	**$ 16,964**	
Interest bearing deposits	$ 454,526	$ 7,945	3.52%	$ 263,671	$ 3,614	2.76%
Borrowings	93,851	2,493	5.36%	35,741	875	4.94%
Junior subordinated debentures	23,449	798	6.86%	15,464	793	10.34%
Total borrowed funds	117,300	3,291	5.66%	51,205	1,668	6.57%
Total interest bearing funds	571,826	11,236	3.96%	314,876	5,282	3.38%
Noninterest checking	183,373			114,428		
Other liabilities	9,734			4,329		
Shareholders equity	74,173			39,421		
Total liabilities and shareholder s equity	**$ 839,106**	**$ 11,236**		**$ 473,054**	**$ 5,282**	
Net interest income		$ 18,964			$ 11,682	
Net interest margin (tax equivalent) [1]			**4.93%**			**5.35%**

[1] Includes tax equivalent adjustments primarily related to tax-exempt income on securities.

Our net interest income changes with the level and mix of average interest-earning assets and average interest-bearing funds. We call the changes between periods in interest-earning assets and interest-bearing funds balance changes. We measure the effect on our net interest income from balance changes by multiplying the change in the average balance between the current period and the prior period by the prior period average rate.

Our net interest income also changes with the average rate earned or paid on interest-earning assets and interest-bearing funds. We call the changes between periods in average rates earned and paid rate changes. We measure the effect on our net interest income from rate changes by multiplying the change in average rates earned or paid between the current period and the prior period by the prior period average balance.

We allocate the change in our net interest income attributable to both balance and rate on a pro rata basis to the change in average balance and the change in average rate.

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	Three months ended June 30, 2007 to 2006 due to:		
(in thousands)	*Rate*	*Volume*	*Total*
Interest income			
Interest on loans	$ 44	$ 8,280	$ 8,324
Interest on securities	(79)	969	890
Interest on Federal funds sold	3	1	4
Interest on deposits with banks	(41)	63	22
Total interest income	(73)	9,313	9,240
Interest expense			
Interest on deposits	296		