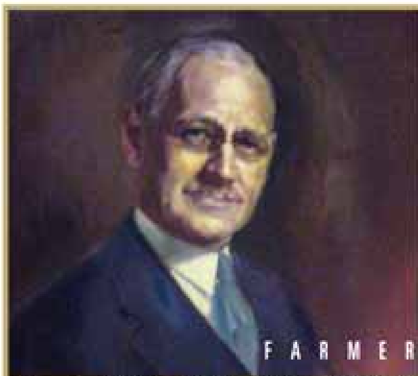

2006 ANNUAL REPORT

FARMERS & MERCHANTS BANK OF LONG BEACH

CELEBRATING 100 YEARS

> > > fmb.com

Farmers & Merchants Bank®

California's Strongest Bank

Member FDIC

Farmers & Merchants Bank®

California's Strongest Bank

Mission Statement

To fulfill the highest standards of business and personal banking through our essential practices of honesty, integrity, and an unparalleled commitment of excellence to our customers and to our employees.

We are dedicated to developing the careers of our employees, both professionally and financially. As we adhere to our Christian Values, we are committed to provide competitive financial strategies, superior products, and exemplary returns to every customer.

Dear Fellow Shareholders:

2006 was an exciting year for Farmers & Merchants Bank as we moved closer to culminating a century of executing the highest standards of business and personal banking in Long Beach and the surrounding communities of Southern California.

The Bank has grown substantially since it was founded in 1907. Our values remain rooted in a tradition of unparalleled commitment to honesty, integrity and excellence on behalf of our loyal customer base.

We understand that by providing competitive financial solutions, we are building a stronger bank for the communities we serve. It is imperative in a fiercely competitive marketplace to provide superior products and exemplary returns to every customer. We believe that our employees' ability to innovate and adhere to the highest standards of service has greatly enhanced the value of Farmers & Merchants Bank.

Despite a challenging operating environment in 2006, we believe the breadth of our products and service excellence enabled us to weather rising interest rates and a consumer shift toward higher-yielding interest-bearing deposit accounts. Our lending team worked together to increase net loans by $238.3 million during the year.

While interest income increased 11 percent over 2005, primarily reflecting growth in our portfolio of variable rate loans, interest expense for 2006 rose 67 percent over the prior year as a result of the combined impact of rising interest rates and a customer shift toward higher-yielding interest-bearing deposit accounts. Overall, net interest income for 2006 increased to $133.2 million from $131.2 million in 2005, and non-interest income for 2006 grew to $11.0 million from $10.5 million last year, mostly indicative of increased revenues from merchant bankcard fees.

For the full year, non-interest expense rose to $52.9 million from $49.4 million in 2005, as we continued to make investments to enhance our long-term prospects. During the year, we augmented our sales organization by hiring experienced lending officers with a strong network of existing relationships.

We also expanded our operations with two new full-service branches opened in Orange County – one in San Clemente and the other in Newport Beach. This year, we opened a third new office in Tustin, which brings our total number of branches in Orange County to 12.

Our Orange County expansion strategy is two fold: establish Farmers & Merchants Bank in one of the most prosperous counties in the United States, and provide greater banking convenience to attract new customers.

We believe our strategic investments will help us enhance long-term value for our shareholders, as well as introduce new and appealing products and services to our retail and commercial customers.

With our 100th anniversary year underway, Farmers & Merchants Bank continues to make strides in serving the community with trustworthy convenience and sound financial strategies. With more than $3 billion in assets, we have the strength and ability to service our customers' banking needs at more than 22 locations and online.

When our Bank was founded, we accepted the Long Beach community's privilege to protect deposits, make safe and secure loans and be available to support the customers we serve. Complementing our 100th anniversary, we have renovated our historic headquarters in downtown Long Beach and welcome you to visit us and take a tour.

We at Farmers & Merchants Bank thank you for allowing us to be your Bank of choice as a customer and shareholder. As we continue to consider expansion opportunities, we remain focused on the entire banking experience and promise of excellence, serving the community and maintaining the integrity that Farmers & Merchants Bank has upheld for 100 years.

Sincerely,

Daniel K. Walker

Daniel K. Walker
Chairman of the Board

FARMERS & MERCHANTS BANK OF LONG BEACH
ANNUAL REPORT

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KPMG LLP
Suite 700
600 Anton Boulevard
Costa Mesa, CA 92626-7651

Independent Auditors' Report

The Board of Directors
Farmers and Merchants Bank of Long Beach:

We have audited the accompanying balance sheets of Farmers and Merchants Bank of Long Beach (the Bank) as of December 31, 2006 and 2005, and the related statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Farmers and Merchants Bank of Long Beach as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As explained in Note 1 to the financial statements, effective January 1, 2006, the Bank changed its method of accounting for share-based payments.

KPMG LLP

Costa Mesa, California
March 8, 2007

KPMG LLP, a U.S. limited liability partnership, is the U.S.
member firm of KPMG International, a Swiss cooperative.

FARMERS & MERCHANTS BANK OF LONG BEACH
BALANCE SHEETS

	December 31, 2006	December 31, 2005
Assets		
Cash and due from banks	$ 119,811,199	$ 114,170,410
Federal funds sold	71,000,000	84,000,000
Total cash and cash equivalents	190,811,199	198,170,410
Securities held-to-maturity (fair value of $1,009,847,335 and $1,265,078,321)	1,021,492,079	1,282,377,297
Securities available-for-sale (cost of $449,502,991 and $464,291,400)	448,689,692	461,053,999
Loans, net	1,352,360,204	1,114,103,473
Bank premises and equipment	24,142,064	23,987,680
Accrued interest receivable	17,022,332	16,245,805
Other assets	18,954,457	18,701,554
Total assets	$ 3,073,472,027	$ 3,114,640,218
Liabilities & Stockholders' Equity		
Liabilities:		
Deposits:		
Demand, non-interest bearing	$ 770,317,100	$ 816,617,233
Demand, interest bearing	210,553,570	237,357,043
Savings and money market savings	487,318,115	633,119,498
Time deposits	597,399,236	452,703,609
Total deposits	2,065,588,021	2,139,797,383
Securities sold under agreements to repurchase	350,806,040	347,775,826
Accrued interest payable and other liabilities	7,419,955	8,100,425
Total liabilities	2,423,814,016	2,495,673,634
Commitments and Contingencies	-	-
Stockholders' equity:		
Common stock, par value $20; authorized 250,000 shares; issued and outstanding 151,090 and 152,982 shares	3,021,800	3,059,640
Surplus	11,269,983	9,115,380
Retained earnings	635,837,568	608,667,767
Accumulated other comprehensive loss	(471,340)	(1,876,203)
Total stockholders' equity	649,658,011	618,966,584
Total liabilities and stockholders' equity	$ 3,073,472,027	$ 3,114,640,218

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF INCOME

	Years Ended December 31, 2006	Years Ended December 31, 2005
Interest income:		
Securities held-to-maturity	$ 50,473,936	$ 49,135,656
Securities available-for-sale	18,730,844	14,815,223
Federal funds sold	3,893,338	3,192,784
Loans	95,296,205	85,050,506
Total interest income	168,394,323	152,194,169
Interest expense:		
Deposits	22,399,171	13,631,455
Securities sold under agreements to repurchase	12,764,216	7,402,214
Total interest expense	35,163,387	21,033,669
Net interest income	133,230,936	131,160,500
Provision for (reduction of) loan losses	901,694	(1,342,576)
Net interest income after provision for (reduction of) loan losses	132,329,242	132,503,076
Non-interest income:		
Service charges on deposit accounts	4,399,055	4,202,579
Merchant bankcard fees	1,217,891	764,595
Escrow fees	1,065,427	1,170,469
Other	4,285,566	4,369,940
Total non-interest income	10,967,939	10,507,583
Non-interest expense:		
Salaries and employee benefits	33,161,229	29,311,600
FDIC and other insurance expense	635,420	705,144
Occupancy expense	5,545,004	4,981,123
Equipment expense	3,518,146	3,905,044
Printing and supplies	1,302,885	1,443,941
Postage and delivery	1,076,528	901,723
Other	7,687,890	8,137,184
Total non-interest expense	52,927,102	49,385,759
Income before income tax expense	90,370,079	93,624,900
Income tax expense	35,154,469	35,952,634
Net income	$ 55,215,610	$ 57,672,266
Basic earnings per common share	$ 363.64	$ 371.26
Diluted earnings per common share	$ 363.16	$ 370.34

See accompanying notes to financial statements.

STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31, 2006	Years Ended December 31, 2005
Net income	$ 55,215,610	$ 57,672,266
Other comprehensive loss, net of tax:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during period	1,404,863	(2,857,901)
Other comprehensive loss	1,404,863	(2,857,901)
Comprehensive income	$ 56,620,473	$ 54,814,365

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

		Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stock-holders' Equity
Balance, December 31, 2004	$	3,128,680	6,440,020	592,712,887	981,698	603,263,285
Issuance of common stock upon exercise of employee stock options		26,440	2,675,360	-	-	2,701,800
Repurchase and retirement of common stock		(95,480)	-	(26,982,407)	-	(27,077,887)
Net income		-	-	57,672,266	-	57,672,266
Cash dividends		-	-	(14,734,979)	-	(14,734,979)
Other comprehensive loss, net of tax benefit		-	-	-	(2,857,901)	(2,857,901)
Balance, December 31, 2005	$	3,059,640	9,115,380	608,667,767	(1,876,203)	618,966,584
Issuance of common stock upon exercise of employee stock options		6,060	569,640	-	-	575,700
Repurchase and retirement of common stock		(43,900)	-	(12,882,930)	-	(12,926,830)
Tax benefit on stock options exercised		-	1,414,963	-	-	1,414,963
Stock option compensation expense		-	170,000	-	-	170,000
Net income		-	-	55,215,610	-	55,215,610
Cash dividends		-	-	(15,162,879)	-	(15,162,879)
Other comprehensive income, net of tax benefit		-	-	-	1,404,863	1,404,863
Balance, December 31, 2006	$	3,021,800	11,269,983	635,837,568	(471,340)	$ 649,658,011

See accompanying notes to financial statements.

FARMERS & MERCHANTS BANK OF LONG BEACH
STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2006	Years Ended December 31, 2005
Cash flows from operating activities:		
Net income	$ 55,215,610	$ 57,672,266
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,511,323	2,874,825
Net amortization on securities	6,062,780	10,179,497
Provision for (reduction of) loan losses	901,694	(1,342,576)
Provision for (reduction of) losses on unfunded commitments	(393,771)	940,926
Deferred income tax benefit	(747,955)	(414,490)
Stock compensation expense	170,000	-
Increase in accrued interest receivable	(776,527)	(1,542,255)
Increase in other assets	(524,185)	(137,962)
(Decrease) increase in accrued interest payable and other liabilities	(286,629)	2,583,273
Total adjustments	6,916,730	13,141,238
Net cash provided by operating activities	62,132,340	70,813,504
Cash flows from investing activities:		
Proceeds from maturities of securities held-to-maturity	321,802,323	306,239,507
Purchases of securities held-to-maturity	(41,672,092)	(425,925,517)
Proceeds from maturities of securities available-for-sale	107,035,332	153,605,920
Purchases of securities available-for-sale	(117,554,788)	(223,332,896)
Net (increase) decrease in loans	(239,158,425)	87,817,833
Purchases of bank premises and equipment	(2,665,707)	(1,715,999)
Net cash provided by (used in) investing activities	27,786,643	(103,311,152)

	Years Ended December 31,	
	2006	2005
Cash flows from financing activities:		
Net (decrease) increase in deposits	$ (74,209,362)	$ 84,601,974
Net increase in securities sold under agreements to repurchase	3,030,214	3,863,195
Issuance of common stock	575,700	2,701,800
Repurchase and retirement of common stock	(12,926,830)	(27,077,887)
Dividends paid	(15,162,879)	(14,734,979)
Tax benefit on stock options exercised	1,414,963	-
Net cash (used in) provided by financing activities	(97,278,194)	49,354,103
Net (decrease) increase in cash and cash equivalents	(7,359,211)	16,856,455
Cash and cash equivalents at beginning of year	198,170,410	181,313,955
Cash and cash equivalents at end of year	$ 190,811,199	$ 198,170,410
Supplemental disclosures of cash flow information:		
Interest paid (including interest credited during the year)	$ 34,961,441	$ 20,653,717
Cash paid during the year for income taxes	34,700,000	35,400,000

See accompanying notes to financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Farmers & Merchants Bank of Long Beach (the "Bank") is an FDIC-insured community bank engaged primarily in commercial lending with a loan portfolio comprised primarily of commercial, real estate and construction loans, most of which are secured. The Bank operates primarily in California's South Los Angeles County and Orange County.

The accounting and reporting policies of Farmers & Merchants Bank of Long Beach are in accordance with accounting principles generally accepted in the United States of America and conform to general practice within the banking industry. Certain reclassifications have been made to prior year amounts to conform to current year presentation.

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and income statement for the year. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the valuation of real estate owned. Management believes that the allowances established on loans and real estate owned are adequate. While management uses available information to recognize losses on loans and real estate owned, future additions to the allowances may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for losses on loans and real estate owned. Such agencies may require the Bank to recognize changes to the allowances based on their judgments about information available to them at the time of their examination.

The Bank is required to carry its available-for-sale securities at fair value and real estate acquired in settlement of loans at the lower of cost or fair value, less estimated selling costs. Fair value estimates are made at a specific point in time based upon relevant market information and other information about the asset. Such estimates related to the investment securities portfolios include published bid prices or bid quotations received from securities dealers. Fair value estimates for real estate acquired in settlement of loans is determined by current appraisals and, where no active market exists for a particular property, discounting a forecast of expected cash flows at the rate commensurate with the risk involved.

Securities Held-to-maturity and Securities Available-for-sale

Securities at December 31, 2006 consist of U.S. Treasury securities, U.S. Government agency obligations, State and Municipal bonds, and mortgage-backed securities. In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debts and Equity Securities* (SFAS No. 115), the Bank classifies its securities into one of two categories: held-to-maturity and available-for-sale. Securities held-to-maturity are those for which the Bank has the ability and positive intent to hold until maturity. All other securities are classified as available-for-sale.

Securities held-to-maturity are recorded at amortized cost, adjusted for the amortization of premiums and accretion of discounts. Securities available-for-sale are carried at fair value. Unrealized holding gains and losses, net of the related tax effect, on securities available-for-sale are excluded from income and reported as a separate component of stockholders' equity identified as accumulated other comprehensive income until realized. Transfers of securities between categories, if any, are recorded at fair value at the date of the transfer. Unrealized holding gains or losses included in the separate component of equity for securities transferred from available-for-sale to held-to-maturity would be maintained and amortized into income over the remaining life of the security as an adjustment to the yield in a manner consistent with the amortization of premium or accretion of discount on the associated security.

NOTE 1 - Summary of Significant Accounting Policies, continued

Securities Held-to-maturity and Securities Available-for-sale, continued

A decline in market value of any held-to-maturity or available-for-sale security below cost that is deemed other than temporary is charged to income resulting in the establishment of a new cost basis for the security.

Premiums and discounts are amortized and accreted over the life of the related securities available-for-sale and securities held-to-maturity as an adjustment to yield using the interest method. Realized gains and losses on securities available-for-sale and securities held-to-maturity are included in income and are derived using the specific-identification method for determining the cost of securities sold.

Loans and Allowance for Loan Losses

Loans are reported at amounts advanced, net of unearned discounts and undisbursed loan funds, less principal payments collected. Unearned interest on discounted loans is accreted into interest income over the lives of the related loans in a manner approximating the interest method.

Interest on loans is accrued as earned. It is the Bank's general practice for interest accruals on loans to be discontinued whenever the payment of interest or principal is 90 days past due. Whenever the accrual of interest is discontinued, previously accrued but uncollected interest income is reversed. Accrual of interest is resumed only when principal and interest are brought fully current and when in management's judgment such loans are deemed fully collectible as to both principal and interest. The accrual of interest on loans that are more than 90 days past due may continue if the loans are well secured, in the process of collection, and management deems it appropriate.

The Bank considers a loan impaired when it is probable that the Bank will be unable to collect all amounts due according to its contractual terms. The amount of an impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or measured against the value of the loan's underlying collateral. Impairment losses are included in the allowance for loan losses through the provision for loan losses. In determining impairment for a specific loan, management evaluates the impairment on an individual loan basis, including an analysis of the credit worthiness, cash flows and financial status of the borrower and the condition and the estimated value of the collateral. The Bank reviews consumer loans by analyzing their performance as a whole because of the relatively homogenous nature of the portfolio. The Bank also includes as impaired loans, all loans on which the accrual of interest has been discontinued and loans which have been restructured. Cash receipts on impaired loans receivable are applied to reduce the principal amount of such loans until the principal has been recovered and are recognized as income thereafter.

Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely, and recoveries are credited to the allowance. The provision for loan losses is established by a charge to expense and added to the allowance to maintain it at a level that management believes, based upon its evaluation of the collectibility and prior loss experience of the portfolio, is adequate to absorb losses inherent in existing loans and commitments to extend credit. That evaluation takes into consideration such factors as changes in the nature and volume of the portfolio, overall problem loans, commitments, and economic conditions that may affect the borrower's ability to pay. Subsequent changes in these factors and related assumptions may warrant adjustments in the level of the allowance for loan losses, based on conditions prevailing at the time.

NOTE 1 – Summary of Significant Accounting Policies, continued

Other Real Estate Owned

Real estate and other assets acquired in satisfaction of indebtedness are carried at fair value less estimated selling costs. Prior to foreclosure, related loan amounts are written down to the fair value of the assets to be acquired by a charge to the allowance for loan losses. Declines in value from the periodic valuation of foreclosed properties are charged against operating expenses and included in the allowance for other real estate owned in the period in which they are identified. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other income or expense as appropriate.

Bank Premises and Equipment

Bank premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is charged to expense over the estimated useful lives of the assets on the straight line method. The useful lives for the principal classes of assets range from 3 years to 20 years. Leasehold improvements are capitalized and amortized on a straight-line basis over the term of the lease or the estimated useful lives of the improvements, whichever is shorter. Maintenance and repairs are charged to expense. Gains or losses on sale or retirement of assets are reported in other income or expense.

Income Taxes

The Bank is subject to Federal and California State income taxes. Income taxes are recorded using the asset and liability method. Under this method, the deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents consist of cash and due from banks and Federal funds sold.

Stock Option Plan

In December 2004, the FASB issued SFAS No. 123R (Revised 2004), Share-Based Payment: an amendment of FASB Statements No. 123 and 95 (SFAS 123R). SFAS 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. Compensation costs should be recognized over the requisite service period. The amount accrued each period until the vesting date is based on the estimated number of awards that are expected to vest, adjusted periodically to reflect the current estimate of forfeitures. SFAS 123R does not express a preference for a type of valuation model to be used in measuring the grant-date fair value that is accrued over the service period. The Bank adopted SFAS 123R on January 1, 2006 and employed the modified prospective method of transition upon implementation. The implementation of this standard did not have a significant impact on the financial statements.

NOTE 1 – Summary of Significant Accounting Policies, continued

Stock Option Plan, continued

Prior to the adoption of SFAS 123R, the Bank applied the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25*, issued in March 2000, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Bank has elected to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in 2005.

	2005
Net income, as reported	$ 57,672,266
Deduct total stock-based employee compensation expense determined under fair-value based method for all rewards, net of tax	(33,831)
Pro forma net income	$ 57,638,435
EPS, as reported	
Basic	371.26
Diluted	370.34
EPS, pro forma	
Basic	371.05
Diluted	370.12

Comprehensive Income

SFAS No. 130, *Reporting Comprehensive Income* (SFAS No. 130) established standards for reporting and presentation of comprehensive income and its components in a full set of financial statements. Comprehensive income consists of net income and net unrealized gains (losses) on securities available-for-sale arising or reclassified during the period, and is presented in the statements of comprehensive income. SFAS No. 130 only requires additional disclosures in the financial statements; it does not affect the Bank's financial position or results of operations.

Earning Per Share (EPS) Data

The table below is a reconciliation of the numerators and denominators used in the calculation of basic and diluted EPS for the years ended December 31, 2006 and 2005. Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock that then would share the earnings of the Bank.

NOTE 1 – Summary of Significant Accounting Policies, continued

Earning Per Share (EPS) Data, continued

		2006		2005
Basic earnings per share:				
Net income available to common stockholders	$	55,215,610	$	57,672,266
Weighted average number of common shares outstanding		151,839		155,340
Weighted basic earnings per common share	$	363.64	$	371.26
Diluted earnings per share:				
Net income available to common stockholders	$	55,215,610	$	57,672,266
Weighted average number of common shares outstanding		151,839		155,340
Impact of stock options		202		388
Average diluted number of common shares outstanding		152,041		155,728
Diluted earnings per common share	$	363.16	$	370.34

Recent Accounting Pronouncements

Accounting for Servicing of Financial Assets

FASB Statement No. 156, *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*, (SFAS No. 156) addresses the recognition and measurement of separately recognized servicing assets and liabilities and to simplify efforts to obtain hedge-like accounting. SFAS No. 156 is effective as of the beginning of the first fiscal year that begins after September 15, 2006. Management believes that the implementation of this Statement will not have a material effect on the Bank's financial results.

Accounting for Uncertainty in Income Taxes

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*, (FIN 48) clarifies the criteria for recognizing tax benefits under FASB Statement No. 109, *Accounting for Income Taxes*. It also requires additional financial statement disclosures about uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006. Management believes that the implementation of this FASB Interpretation will not have a material effect on the Bank's financial results.

Fair Value Measurements

FASB Statement No. 157, *Fair Value Measurements*, defines fair value, establishes a framework for measuring fair value in GAAP, and requires enhanced disclosures about fair value measurements. This Statement applies when other accounting pronouncements require or permit fair value measurements; it does not require new fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. Implementation of this Statement is not expected to have a material impact on the Bank's financial results.

NOTE 1 - Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R),* (SFAS No. 158) requires an employer to recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. This Statement is effective for nonpublic entities for fiscal years ending after June 15, 2007. Implementation of this Statement is not expected to have an impact on the Bank's financial results.

The Fair Value Option for Financial Assets and Financial Liabilities

FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment to FASB Statement No. 115*, (SFAS No. 159) was issued in February 2007. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. Adoption of this Statement is required for the fiscal year that begins after November 15, 2007. Management is in the process of evaluating the anticipated impact of this Statement on the Bank's financial statements.

NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments are defined under SFAS No. 107, *Disclosures About Fair Value of Financial Instruments* (SFAS No. 107), as cash, evidence of an ownership in an entity, or a contract that conveys or imposes on an entity the contractual right or obligation to either receive or deliver cash or another financial instrument. A significant portion of the Bank's assets and liabilities are financial instruments as defined under SFAS No. 107.

The following presents a description of the Bank's financial instruments and the methodologies and assumptions used to estimate their fair value. Much of the information used to determine fair value is highly subjective. When applicable, readily available market information has been utilized. However, for a significant portion of the Bank's financial instruments, active markets do not exist. Therefore, considerable judgments were required in estimating fair value of certain items. The subjective factors include, among other things, the estimated timing and amount of cash flows, risk characteristics, credit quality and interest rates, all of which are subject to change. Since the fair value is estimated as of December 31, 2006 and 2005, the amounts that will actually be realized could be significantly different.

Cash and Cash Equivalents

The carrying value of cash and cash equivalents approximates the fair value because of the short maturity of such assets.

Securities Held-to-maturity and Securities Available-for-sale

The Bank used market quotes for similar or identical securities in an actively traded market to determine the fair values of securities held-to-maturity and securities available-for-sale as disclosed in Notes 4 and 5, respectively.

NOTE 2 – Fair Value of Financial Instruments, continued

Loans

The fair value of performing and non-performing loans was determined by a discounted cash flow analysis based on the Bank's current lending rates and discount rates that management believes would have been obtained had management elected to sell the entire loan portfolio on December 31, 2006 or 2005.

Deposits

The fair value of demand deposits, savings and money market saving accounts was determined to approximate the carrying value as they are immediately withdrawable. For fixed maturity time deposits, the fair value was estimated by discounting expected cash flows by the current offering rates of term deposits with similar maturities. In accordance with SFAS No. 107, no value has been assigned to the Bank's long-term relationship with its deposit customers (core deposit intangibles) since it is not a financial instrument as defined under SFAS No. 107.

Securities Sold Under Agreements to Repurchase

The fair value of securities sold under agreements to repurchase approximates their carrying value due to the terms and nature of the obligations.

Off-Balance Sheet Financial Instruments

As the standby letters of credit and commitments to lend have terms that are consistent with current market terms, the Bank estimates that the fair value of the fees charged to enter into such agreements to be nominal.

The following table presents estimated fair value information for the Bank's loans and deposits at December 31:

	2006	
	Carrying Value	Estimated Fair Value
Loans, net of allowance for loan losses	$ 1,352,360,204	$ 1,222,589,328
Deposits:		
Demand, non-interest bearing	$ 770,317,100	$ 770,317,100
Demand, interest bearing	210,553,570	210,553,570
Savings and money market savings	487,318,115	487,318,115
Time deposits	597,399,236	597,345,564
	$ 2,065,588,021	$ 2,065,534,349

NOTE 2 – Fair Value of Financial Instruments, continued

	2005	
	Carrying Value	Estimated Fair Value
Loans, net of allowance for loan losses	$ 1,114,103,473	$ 979,861,234
Deposits:		
Demand, non-interest bearing	$ 816,617,233	$ 816,617,233
Demand, interest bearing	237,357,043	237,357,043
Savings and money market savings	633,119,498	633,119,498
Time deposits	452,703,609	453,059,174
	$ 2,139,797,383	$ 2,140,152,948

NOTE 3 - SECURITIES HELD-TO-MATURITY

The following is a summary of securities held-to-maturity:

	December 31,	
	2006	2005
Carrying Value:		
U.S. Treasury securities	$ 14,904,562	$ 39,801,697
U.S. Government agency obligations	39,721,181	53,443,014
State and Municipal securities	152,640,362	182,912,504
Mortgage-backed securities	814,225,974	1,006,220,082
	$ 1,021,492,079	$ 1,282,377,297
Approximate Fair Value:		
U.S. Treasury securities	$ 14,674,399	$ 39,334,751
U.S. Government agency obligations	39,886,023	53,198,725
State and Municipal securities	152,521,984	182,219,002
Mortgage-backed securities	802,764,929	990,325,843
	$ 1,009,847,335	$ 1,265,078,321
Gross Unrealized Gains:		
U.S. Government agency obligations	$ 301,808	$ 281,478
State and Municipal securities	447,793	713,937
Mortgage-backed securities	906,476	2,186,477
	1,656,077	3,181,892
Gross Unrealized Losses:		
U.S. Treasury securities	230,163	466,946
U.S. Government agency obligations	136,966	525,767
State and Municipal securities	566,171	1,407,439
Mortgage-backed securities	12,367,521	18,080,716
	13,300,821	20,480,868
Net Unrealized (Losses) Gains	$ (11,644,744)	$ (17,298,976)

NOTE 3 – Securities Held-to-Maturity, continued

Maturities at December 31, 2006:	Carrying Value	Estimated Fair Value
Due in 1 year or less	$ 66,869,146	$ 66,889,312
Due after 1 year through 5 years	107,343,075	107,249,820
Due after 5 years through 10 years	33,053,884	32,943,274
Mortgage-backed securities	814,225,974	802,764,929
	$ 1,021,492,079	$ 1,009,847,335

There were no sales of securities held-to-maturity in 2006 or 2005. There were no transfers of securities from held-to-maturity to available-for-sale in 2006 or 2005.

Gross unrealized losses on held-to-maturity securities and the fair value of the related held-to-maturity securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ -	$ -	$ 14,674,400	$ 230,163	$ 14,674,400	$ 230,163
U.S. Government agency obligations	-	-	13,759,269	136,966	13,759,269	136,966
State and Municipal securities	10,654,772	22,904	74,418,781	543,268	85,073,553	566,172
Mortgage-backed securities	36,184,687	145,747	674,702,227	12,221,773	710,886,914	12,367,520
Total temporarily impaired securities	$ 46,839,459	$ 168,651	$ 777,554,677	$ 13,132,170	$ 824,394,136	$ 13,300,821

The Bank's held-to-maturity portfolio is primarily comprised of mortgage-backed securities issued or guaranteed by FNMA (Fannie Mae) or GNMA (Ginnie Mae). The unrealized losses on mortgage-backed securities are primarily attributable to declining market prices caused by an increasing rate environment. At December 31, 2006, there were 32 and 324 held-to-maturity securities with unrealized losses less than 12 months and 12 months or longer, respectively.

At December 31, 2006, management believes that held-to-maturity securities in an unrealized loss position were temporary in nature, and therefore no impairment losses were recognized in the statement of income. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these held-to-maturity securities are not considered other-than-temporarily impaired.

NOTE 3 – Securities Held-to-Maturity, continued

Total securities with a carrying value of approximately $457,069,550 and $406,439,374 at December 31, 2006 and December 31, 2005, respectively, were pledged to secure public deposits and for other purposes required by law.

Interest income on tax-exempt securities was $4,564,418 for the year ended December 31, 2006, and $4,051,562 for the year ended December 31, 2005.

NOTE 4 - SECURITIES AVAILABLE-FOR-SALE

The following is a summary of securities available-for-sale:

	December 31,	
	2006	2005
Amortized Cost:		
U.S. Treasury securities	$ 39,961,567	$ 89,640,172
U.S. Government agency obligations	301,809,563	306,626,851
State and municipal securities	20,028,328	875,000
Mortgage-backed securities	87,703,533	67,149,377
	$ 449,502,991	$ 464,291,400
Approximate Fair Value:		
U.S. Treasury securities	$ 39,861,800	$ 89,225,323
U.S. Government agency obligations	300,747,955	303,151,989
State and municipal securities	20,087,682	875,000
Mortgage-backed securities	87,992,255	67,801,687
	$ 448,689,692	$ 461,053,999
Gross Unrealized Gains:		
U.S. Government agency obligations	$ 326,073	$ -
State and municipal securities	65,348	-
Mortgage-backed securities	784,136	1,224,703
	1,175,557	1,224,703
Gross Unrealized Losses:		
U.S. Treasury securities	99,767	414,849
U.S. Government agency obligations	1,387,681	3,474,862
State and municipal securities	5,994	-
Mortgage-backed securities	495,414	572,393
	1,988,856	4,462,104
Net Unrealized Losses	$ (813,299)	$ (3,237,401)

NOTE 4 - Securities Available-for-Sale, continued

Maturities at December 31, 2006:

	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$ 236,777,194	$ 235,659,582
Due after 1 year through 5 years	113,899,333	113,874,649
Due after 5 years through 10 years	11,122,931	11,163,206
Mortgage-backed securities	87,703,533	87,992,255
	$ 449,502,991	$ 448,689,692

Gross realized loss on sale of securities of $307 was recognized for 2006. There were no sales of securities in 2005.

Gross unrealized losses on available-for-sale securities and the fair value of the related available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2006 were as follows:

	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury securities	$ -	$ -	$ 39,861,900	$ 99,767	$ 39,861,900	$ 99,767
U.S. Government agency obligations	59,868,952	113,611	180,447,377	1,274,070	240,316,329	1,387,681
State and municipal securities	2,296,645	4,540	660,984	1,454	2,957,629	5,994
Mortgage-backed securities	36,040,233	441,120	6,970,834	54,294	43,011,067	495,414
Total temporarily impaired securities	$ 98,205,830	$ 559,271	$ 227,941,095	$ 1,429,585	$ 326,146,925	$ 1,988,856

The unrealized losses on investments in U.S. Government agency obligations were caused by interest rate increases. At December 31, 2006, there were 20 available-for-sale securities with unrealized losses less than 12 months and 42 available-for-sale securities with unrealized losses 12 months or longer. Whenever the cost of an investment security exceeds its fair value, management evaluates, among other factors, general market conditions, the duration and extent to which cost is more than fair value.

At December 31, 2006, management believes that available-for-sale securities in an unrealized loss position were temporary in nature, and therefore no impairment losses were recognized in the income statement. Because the Bank has the ability and intent to hold these investments until a market price recovery or maturity, these available-for-sale securities are not considered other-than-temporarily impaired.

NOTE 4 - Securities Available-for-Sale, continued

The following represents the related tax effect allocated to each component of other comprehensive income for the year ended December 31, 2006:

	Before-Tax Amount	Tax Expense	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding gains arising during period	$ 2,424,102	$ (1,019,239)	$ 1,404,863
Other comprehensive loss	$ 2,424,102	$ (1,019,239)	$ 1,404,863

The following represents the related tax effect allocated to each component of other comprehensive income for the year ended December 31, 2005:

	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding losses arising during period	$ (4,931,328)	$ 2,073,427	$ (2,857,901)
Other comprehensive loss	$ (4,931,328)	$ 2,073,427	$ (2,857,901)

NOTE 5 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The following is a summary of the major categories of loans:

	December 31, 2006	December 31, 2005
Commercial	$ 170,790,729	$ 100,422,640
Real estate	1,035,085,339	919,458,666
Construction	157,515,685	107,047,326
Consumer	12,647,009	10,036,231
	1,376,038,762	1,136,964,863
Less: Allowance for loan losses	(23,678,558)	(22,861,390)
Loans, net	$ 1,352,360,204	$ 1,114,103,473

NOTE 5 – Loans and Allowance for Loan Losses, continued

Activities in the allowance for loan losses for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005
Balance, beginning of year	$ 22,861,390	$ 24,215,690
Provision for loan losses	901,694	(1,342,576)
Charge-offs	(120,601)	(91,495)
Recoveries	36,075	79,771
Balance, end of year	$ 23,678,558	$ 22,861,390

The loan portfolio is composed mainly of credit extended to borrowers in Southern California with the majority of loans secured by real estate, even though a substantial amount of the Bank's loans are intended for business purposes. There is no concentration of loans to borrowers in a specific industry within the commercial loan portfolio.

Loans on which the accrual of interest has been discontinued amounted to $1,883,895 at December 31, 2006, and $1,114,132 at December 31, 2005. If interest on these loans had been accrued, interest income would have been increased by approximately $365,588 in 2006, and $176,325 in 2005.

During 2006 and 2005, the Bank recorded $221,931 and $489,446, respectively, in interest income recoveries on loans that had previously been on non-accrual.

Loans 90 days or more past due as to interest and/or principal which remain on accrual status approximated $17,948,739 at December 31, 2006 and $5,874,104 at December 31, 2005.

Included in the Bank's loan portfolio are restructured loans which are those loans whose terms have been modified because of a deterioration in the financial condition of the borrower. The total amount of restructured loans were $1,225,014 at December 31, 2006 and $1,326,891 at December 31, 2005.

At December 31, 2006, there was no recorded investment in loans for which an impairment has been recognized. At December 31, 2005, the recorded investment in loans for which an impairment has been recognized was $5,096 and the related allowance for loan losses was $5,096. The recorded investment in loans considered impaired and for which no specific allowance has been recorded was $3,108,909 at December 31, 2006 and $2,435,927 at December 31, 2005. The average recorded investment in impaired loans during 2006 and 2005 was $1,846,420 and $4,477,458, respectively. Interest income recognized on impaired loans was $330,833 during 2006 and $598,156 during 2005.

The Bank had outstanding loan commitments of $428,418,725 and $421,506,872 at December 31, 2006 and 2005, respectively. Substantially, all of the Bank's loan commitments are on a variable rate basis and are comprised of real estate loan commitments. Activities in the reserve for unfunded commitments included in other liabilities in the accompanying balance sheet for the years ended December 31, 2006 and 2005 were as follows:

NOTE 5 – Loans and Allowance for Loan Losses, continued

	2006	2005
Balance, beginning of year	$ 3,586,401	$ 2,645,475
Provision for losses on unfunded commitments	(393,771)	940,926
Charge-offs	-	-
Recoveries	-	-
Balance, end of year	$ 3,192,630	$ 3,586,401

NOTE 6 - BANK PREMISES AND EQUIPMENT

The following is a summary of bank premises and equipment at December 31:

	2006	2005
Land	$ 5,706,720	$ 5,706,720
Buildings	21,183,187	20,780,573
Furniture, fixtures and equipment	16,165,032	15,764,973
Leasehold improvements	2,858,492	2,643,407
	45,913,431	44,895,673
Less accumulated depreciation and amortization	(21,771,367)	(20,907,993)
	$ 24,142,064	$ 23,987,680

Depreciation and amortization expense was $2,511,323 in 2006 and $2,874,825 in 2005.

The Bank is committed under operating leases on certain premises and equipment. Certain leases require the Bank to pay property taxes and insurance. Rental payments were $1,136,794 in 2006, and $700,884 in 2005, net of sublease income of $369,585 and $355,822, respectively. Annual minimum lease commitments at December 31, 2006 were:

2007	$ 1,341,777
2008	1,466,451
2009	1,265,694
2010	1,280,900
2011	1,215,615
Thereafter	5,525,270

Management expects that in the normal course of business, leases that expire will be renewed or replaced by other leases.

NOTE 7 - TIME DEPOSITS

The following is a summary of time deposits:

	December 31, 2006	December 31, 2005
Time deposits less than $100,000	$ 203,665,480	$ 164,478,064
Time deposits of $100,000 and over	393,733,756	288,225,545
	$ 597,399,236	$ 452,703,609

Interest expense on time deposits of $100,000 and over totaled $11,555,970 and $6,275,476 for the years ended December 31, 2006, and 2005, respectively.

At December 31, 2006, the maturity distribution of the Bank's time deposits was as follows:

2007	$ 577,994,709
2008	16,006,424
2009	3,221,340
2010	176,763
	$ 597,399,236

NOTE 8 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

At December 31, 2006 and 2005, securities sold under agreements to repurchase totaled $350,806,040 and $347,775,826 and carried weighted average interest rates of 4.15% and 2.82%, respectively. The securities underlying these agreements were U.S. Treasury securities, U.S. Government agency obligations and mortgage-backed securities with carrying values of $404,201,850 and $357,735,864 and fair values of $401,661,373 and $353,880,382, at December 31, 2006 and 2005, respectively. The securities underlying these agreements are held by a custodian bank until the maturity of the agreement. The identical securities will be repurchased by the Bank.

The average outstanding amounts of securities sold under agreements to repurchase (based upon daily balances) were $339,195,852 in 2006, and $341,174,224 in 2005. The weighted average interest rates were 3.76% in 2006, and 2.17% in 2005, and the maximum amounts outstanding during the periods were $392,280,844 and $406,907,109, respectively. All agreements in 2006 and 2005 are short term with maturities in a range of 6 to 8 weeks.

NOTE 9 - INCOME TAXES

The provision for income taxes for the years ended December 31, 2006 and 2005, is comprised of the following:

	2006	2005
Current:		
Federal	$ 27,152,378	$ 27,436,249
State	8,750,046	8,930,875
Total	35,902,424	36,367,124
Deferred:		
Federal	(704,002)	(495,811)
State	(43,953)	81,321
Total	(747,955)	(414,490)
Total income tax expense	$ 35,154,469	$ 35,952,634

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2006 are as follows:

	Assets	Liabilities
Allowance for loan losses	$ 12,313,017	$ -
Discount accretion income	-	36,006
State income taxes	1,812,439	-
Depreciation and amortization	896,534	-
Deferred gain on sale of other real estate owned	195,293	-
Fair value adjustments on securities available-for-sale	341,960	-
Other, net	1,042,930	-
Total deferred taxes	$ 16,602,173	$ 36,006

Based on management's review of the recoverability of the net deferred tax asset above, no valuation allowance was considered necessary as of December 31, 2006. The net deferred tax asset is included in other assets in the accompanying balance sheets.

Significant temporary differences that give rise to the deferred tax assets and liabilities as of December 31, 2005 are as follows:

	Assets	Liabilities
Allowance for loan losses	$ 12,123,668	$ -
Discount accretion income	-	78,150
State income taxes	2,069,823	-
Depreciation and amortization	278,810	-
Deferred gain on sale of other real estate owned	195,293	-
Fair value adjustments on securities available-for-sale	1,361,197	-
Other, net	886,804	-
Total deferred taxes	$ 16,915,595	$ 78,150

NOTE 9 – Income Taxes, continued

Based on management's review of the recoverability of the net deferred tax asset above, no valuation allowance was considered necessary as of December 31, 2005.

The Federal tax rate was 35% for 2006 and 2005. A reconciliation of income tax expense and the amount computed by applying the "expected" Federal income tax rate to income before income taxes follows:

	2006	2005
Federal income tax rate	35.0%	35.0%
State income taxes, net of Federal benefit	6.3%	6.3%
Tax exempt income	(1.8%)	(1.5%)
Other, primarily tax credits	(0.6%)	(1.4%)
	38.9%	38.4%

NOTE 10 - COMMITMENTS, CONTINGENCIES AND OFF-BALANCE SHEET RISK

In the normal course of business, there are various outstanding commitments and contingencies, such as financial instruments with off balance sheet risk, which are not reflected in the accompanying financial statements. These financial instruments primarily consist of commitments to extend credit and standby letters of credit issued to meet the financing needs of the Bank's customers. Management does not anticipate any material losses as a result of these transactions.

Commitments to extend credit and standby letters of credit only represent exposure to risk in the event the contract is drawn upon and the other party to the contract defaults. The actual credit risk of these transactions depends upon the credit worthiness of the customer and on the value of any related collateral. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The Bank had outstanding loan commitments of $428,418,725 and $421,506,872 at December 31, 2006 and 2005, respectively. Substantially, all of the Bank's loan commitments are on a variable rate basis and are comprised of real estate loan commitments.

Standby letters of credit amounting to $60,217,224 and $67,045,337 were outstanding at December 31, 2006 and 2005, respectively. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Where appropriate, cash or other security support is held as collateral.

From time to time, the Bank is a defendant or plaintiff in various legal proceedings, including litigation arising in the ordinary course of its business. To date, none of these types of litigation has had a material effect on the Bank and, as of December 31, 2006, the Bank is not a party to any material litigation except as described below.

NOTE 10 – Commitments, Contingencies and Off-Balance Sheet Risk, continued

In March 2004, in the Superior Court of the State of California for the County of Orange, plaintiff Marcus D. Walker filed a purported shareholder derivative and class action complaint against seven past and present members of the Bank's Board of Directors, also against the Bank's Chief Executive Officer and Executive Vice President. The Bank is named solely as a nominal defendant in relation to the purported derivative claims. Plaintiff's second amended complaint generally alleges that the individual defendants breached their fiduciary duties to the Bank and its shareholders by, *inter alia*, permitting the Bank to accumulate an overly large capital surplus, by adopting corporate resolutions concerning dividends, executive compensation, registration of the Bank's stock and other matters without adequate discussion or consideration of the issues. Plaintiff further alleges that certain transactions between the Bank and Farmers & Merchants Trust Company of Long Beach were approved without consideration of potential conflicts of interest or alternative sources of services. Based on these allegations, plaintiff requests from the individual defendants an award of general, special, and punitive damages, disgorgement, and also attorneys' fees and costs. After the Court sustained their demurrers to several causes of action with prejudice, defendants answered the second amended complaint by generally denying plaintiff's allegations and asserting various affirmative defenses. On April 10, 2006, the Court denied Plaintiff's motion for class certification. On May 16, 2006, Plaintiff filed a notice of appeal from the April 10, 2006 court order. The case is now proceeding in the Superior Court solely on plaintiff's alleged derivative claims.

Considerable discovery and motion practice has taken place. The parties have also engaged in mediation. Unless the case is settled or the trial delayed, the case is presently set for trial in May 2007. The Bank is advancing all attorneys' fees and costs of the defendants pursuant to its charter documents and indemnification agreements. During 2006 and 2005, approximately $906,048 and $547,316, respectively, was advanced by the Bank in this matter. There can be no assurances that the Bank will not incur additional material expenses in the defense and resolution of this matter through indemnity or otherwise. The degree of probability of an unfavorable outcome could not be determined, and the amount of liability or loss relating to this case, if any, could not be reasonably estimated as of December 31, 2006.

NOTE 11 – STOCKHOLDERS' EQUITY AND STOCK OPTION PLAN

In 2005, the Board of Directors approved a stock repurchase program wherein the Bank was authorized to repurchase up to $50,000,000 of its common stock. As of December 31, 2006 and 2005, the Bank repurchased 2,195 and 4,774 shares for a total price of $12,926,830 and $27,077,887, respectively, and thereafter retired the shares.

In 1997, the Bank adopted a stock option plan (the "Plan") pursuant to which the Board of Directors may grant stock options to officers and key employees. The Plan authorizes grants of options to purchase up to 15,000 shares of authorized but unissued common stock. The Board granted 4,550 options in 1997 and another 1,250 options during 2000. Stock options are granted with an exercise price equal to the stock's fair value at the date of the grant. Stock options have 5 to 10-year terms and vest and become fully exercisable after 5 to 10 years from the date of grant. No options were granted during 2006 and 2005. During 2006 and 2005, 303 and 1,322 options, respectively, became exercisable and were exercised during the year.

The weighted average exercise price of outstanding options at December 31, 2006 was $1,900. The weighted average remaining life of the outstanding options at December 31, 2006 was 3 months.

NOTE 11 – Stockholders' Equity and Stock Option Plan, continued

Stock option activity during the periods indicated is as follows:

	Number of Shares	Weighted-Average Exercise Price
Balance at January 1, 2005	2,040	$ 1,975
Granted	-	-
Exercised	(1,322)	$ 2,044
Forfeited	-	-
Expired	-	-
Balance at December 31, 2005	718	$ 1,900
Granted	-	-
Exercised	(303)	$ 1,900
Forfeited	(30)	$ 1,900
Expired	-	-
Balance at December 31, 2006	385	$ 1,900

A summary of the status of the Bank's nonvested shares as of December 31, 2006, and changes during the year ended December 31, 2006, is presented below:

Nonvested Shares	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	718	$ 440.69
Granted	-	-
Vested	(303)	$ 458.63
Forfeited	(30)	$ 458.63
Nonvested at December 31, 2006	385	$ 425.18

As of December 31, 2006, there was $49,548 of total unrecognized compensation cost related to nonvested options granted under the Plan. That cost is expected to be recognized in 2007 when all of the options will be vested. The average fair value of shares vested during the years ended December 31, 2006 and 2005 was $5,688 and $5,500, respectively.

NOTE 12 - AFFILIATED PARTY TRANSACTIONS

At December 31, 2006, no credit was extended to any director or any company in which a director had an interest. At December 31, 2005, there was one loan, with remaining outstanding balance of $332,000, that the Bank extended to a company in which a director had an interest. This loan was paid off in 2006. The original balance of this loan was $700,000, with a term of six years at prime rate, interest only for the first twelve months and principal and interest thereafter. In the opinion of management, the terms of this loan were the same that would be offered to any other borrower of similar financial strength and collateral.

NOTE 12 – Affiliated Party Transactions, continued

The Bank and Farmers & Merchants Trust Company of Long Beach (Trust Co.) are affiliated parties as a substantial percentage of the outstanding shares of the Bank and the parent company of the Trust Co. are held by common shareholders, which include Richard Darling, William Hayter, Lawrence McLaughlin, Daniel K. Walker, Kenneth G. Walker and W. Henry Walker, each of whom is either a director and/or an officer of the Bank. In addition, certain officers and/or directors of the Bank are also officers and/or directors of the parent company of the Trust Co. and its subsidiaries, including the Trust Company. The Bank provides administrative, accounting and data processing services as well as office space to the Trust Co. The Trust Co. provides trustee and financial management services to the Bank and maintains deposits with the Bank. The Bank and the Trust Co. have entered into an agreement for the exchange of services, which will result in a periodic settlement of amounts owed. This agreement was unanimously approved by their respective audit committee and Board of Directors. Such amounts were not significant for the years ended December 31, 2006 and 2005, and during 2006 the Trust Co. paid to the Bank $2,078 pursuant to the agreement for the exchange of services for the prior year.

The Bank leases a branch location from the Trust Co.'s parent corporation. The Bank paid $277,456 and $124,664, respectively, in rent pursuant to this lease for each of the years ended December 31, 2006 and 2005.

NOTE 13 - PROFIT-SHARING PLAN

The Bank has a noncontributory profit-sharing plan in which employees are eligible to participate at year-end if they have been employed for at least 1,000 hours during the year. The Bank contributed $3,247,768 and $2,899,163 to the profit-sharing plan in 2006 and 2005, respectively. At December 31, 2006 and December 31, 2005, no shares of the Bank's stock are held by the trust created by the plan.

NOTE 14 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the Federal and State banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2006, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

NOTE 14 – Regulatory Matters, continued

The Bank's actual regulatory capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2006:						
Total Capital (to Risk-Weighted Assets)	$671,601,458	39.22%	≥$136,989,563	≥8.0%	≥$171,236,954	≥10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$650,129,350	37.97%	≥$ 68,494,782	≥4.0%	≥$102,742,173	≥ 6.0%
Tier 1 Capital (to Average Assets)	$650,129,350	21.32%	≥$121,948,130	≥4.0%	≥$152,435,163	≥ 5.0%

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2005:						
Total Capital (to Risk-Weighted Assets)	$639,822,327	42.3%	≥$118,634,605	≥8.0%	≥$148,293,257	≥10.0%
Tier 1 Capital (to Risk-Weighted Assets)	$620,842,787	41.1%	≥$ 59,317,303	≥4.0%	≥$ 88,975,954	≥ 6.0%
Tier 1 Capital (to Average Assets)	$620,842,787	20.2%	≥$122,147,140	≥4.0%	≥$152,683,925	≥ 5.0%

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