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INDEPENDENT AUDITOR'S REPORT

The Shareholders and
Board of Directors
Redwood Capital Bank
Eureka, California

We have audited the accompanying balance sheets of Redwood Capital Bank (the Bank) as of December 31, 2005 and 2004, and the related statements of operations, changes in shareholders' equity and cash flows for the year ended December 31, 2005 and the period from inception (November 3, 2004) through December 31, 2004. 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 the Bank as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the year ended December 31, 2005 and the initial period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

Richardson & Company

February 10, 2006

REDWOOD CAPITAL BANK

BALANCE SHEET

December 31, 2005 and 2004

	2005	2004
ASSETS		
Cash and due from banks	$ 3,987,470	$ 3,028,015
Federal funds sold	5,925,000	9,355,000
Cash and cash equivalents	9,912,470	12,383,015
Interest-bearing deposits in other banks		3,564,000
Investment securities available-for-sale, at fair value	13,576,473	10,727,304
Loans, net	54,627,368	22,756,493
Premises and equipment, net	2,420,340	2,515,018
Accrued interest receivable and other assets	662,618	215,743
	71,286,799	39,778,558
TOTAL ASSETS	$ 81,199,269	$ 52,161,573
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Non interest-bearing	$ 17,211,395	$ 10,678,240
Interest-bearing	55,595,917	33,026,473
Total deposits	72,807,312	43,704,713
Accrued interest payable and other liabilities	439,084	145,733
TOTAL LIABILITIES	73,246,396	43,850,446
Commitments and contingencies (see accompanying notes)		
SHAREHOLDERS' EQUITY		
Preferred stock, no par value; 10,000,000 shares authorized; no shares issued and outstanding		
Common stock, no par value; 30,000,000 shares authorized; 1,102,000 and 1,100,000 shares issued and outstanding in 2005 and 2004	11,163,574	11,045,270
Accumulated deficit	(3,025,293)	(2,714,008)
Accumulated other comprehensive loss	(185,408)	(20,135)
TOTAL SHAREHOLDERS' EQUITY	7,952,873	8,311,127
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 81,199,269	$ 52,161,573

The accompanying notes are an integral part of these financial statements.

REDWOOD CAPITAL BANK

STATEMENTS OF OPERATIONS

For the Year Ended December 31, 2005 and the Period Ended December 31, 2004

	2005	2004
INTEREST INCOME		
Interest and fees on loans	$ 2,912,049	$ 532,132
Interest on taxable investment securities	428,932	172,500
Dividend income	5,287	
Interest on federal funds sold	201,083	115,142
Interest on deposits in banks	50,935	45,737
Total interest income	3,598,286	865,511
INTEREST EXPENSE		
Interest on deposits	839,322	200,544
Interest on other borrowings	136	5,733
Total interest expense	839,458	206,277
NET INTEREST INCOME	2,758,828	659,234
Provision for loan losses	375,000	350,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	2,383,828	309,234
OTHER INCOME		
Service charges and fees	108,262	27,044
Other income	432,517	98,472
Total other income	540,779	125,516
OTHER EXPENSES		
Salaries and employee beneits	1,690,988	1,028,884
Occupancy and equipment	421,366	278,838
Other	1,122,738	1,839,436
Total other expenses	3,235,092	3,147,158
Income before provision for income taxes	(310,485)	(2,712,408)
Provision for income taxes	800	1,600
NET INCOME	$ (311,285)	$ (2,714,008)
NET INCOME PER SHARE	$ (0.28)	$ (2.47)
NET INCOME PER SHARE -ASSUMING DILUTION	$ (0.26)	$ (2.31)

The accompanying notes are an integral part of these financial statements.

REDWOOD CAPITAL BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Year Ended December 31, 2005 and the Period Ended December 31, 2004

	Comprehensive Income	Common Stock Shares	Common Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Sale of 1,100,000 shares of common stock at $10 per share less costs related to the stock offering		1,100,000	$ 10,951,892			$ 10,951,892
Stock options granted			93,788			93,788
Comprehensive income:						
Net loss	$ (2,714,008)			$ (2,714,008)		(2,714,008)
Other comprehensive loss:						
Unrealized holding losses on securities available-for-sale arising during the year	(20,135)				$ (20,135)	(20,135)
Total comprehensive loss	$ (2,734,143)					
BALANCE AT DECEMBER 31, 2004		1,100,000	11,045,270	(2,714,008)	(20,135)	8,311,127
Stock options exercised		2,000	20,000			20,000
Stock options granted			98,304			98,304
Comprehensive income:						
Net loss	$ (311,285)			(311,285)		(311,285)
Other comprehensive loss:						
Unrealized holding losses on securities available-for-sale arising during the year	(165,273)				(165,273)	(165,273)
Total comprehensive loss	$ (476,558)					
BALANCE AT DECEMBER 31, 2005		1,102,000	$ 11,163,574	$ (3,025,293)	$ (185,408)	$ 7,952,873

The accompanying notes are an integral part of these financial statements.

REDWOOD CAPITAL BANK

STATEMENTS OF CASH FLOWS

For the Year Ended December 31, 2005 and the Period Ended December 31, 2004

	2005	2004
OPERATING ACTIVITIES		
Net loss	$ (311,285)	$ (2,714,008)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for loan losses	375,000	350,000
Deferred loan origination fees and costs, net	100,193	46,285
Depreciation and amortization	201,294	165,035
Stock options granted	98,304	93,377
Increase in accrued interest receivable and other assets	(651,375)	(215,743)
Increase in accrued interest payable and other liabilities	293,351	145,733
NET CASH PROVIDED BY OPERATING ACTIVITIES	105,482	(2,129,321)
INVESTING ACTIVITIES		
Net change in interest-bearing deposits in banks	3,564,000	(3,564,000)
Purchase of available-for-sale investment securities	(7,488,882)	(10,906,938)
Proceeds from maturity of available-for-sale investment securities	4,000,000	126,666
Proceeds from paydowns on mortgage-backed securities	487,633	
Purchase of Federal Home Loan Bank stock	204,500	
Net increase in loans	(32,346,068)	(23,152,778)
Purchase of premises and equipment	(119,809)	(2,647,220)
NET CASH USED BY INVESTING ACTIVITIES	(31,698,626)	(40,144,270)
FINANCING ACTIVITIES		
Net increase in deposits	29,102,599	43,704,713
Proceeds from issuance of stock, net of costs		10,951,893
Proceeds from exercise of stock options	20,000	
NET CASH PROVIDED BY FINANCING ACTIVITIES	29,122,599	54,656,606
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,470,545)	12,383,015
Cash and cash equivalents at beginning of year	12,383,015	-
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 9,912,470	$ 12,383,015
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 789,304	$ 191,419
Income taxes	$ 800	$ 1,600
SUPPLEMENTAL DISCLOSURES OF NONCASH ACTIVITIES		
Net change in unrealized gains/losses on available-for-sale investment securities	$ (165,273)	$ (20,135)

The accompanying notes are an integral part of these financial statements.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business: Redwood Capital Bank (the Bank) was incorporated on November 3, 2003, received its state banking charter early in 2004, and commenced operations on March 24, 2004. The Bank was organized from mid 2002 through March 2004, when it opened for business. During the organizational period from inception through March 24, 2004, the Bank incurred approximately $820,064 in pre-opening expenses which were partially offset by pre-opening revenue of approximately $8,478 earned primarily from interest income on the proceeds from the sale of the Bank's common stock. Pre-opening revenue and expenses have been included in the Statement of Operations and charged to accumulated deficit during the Bank's initial reporting period ended December 31, 2004. The Bank is subject to regulation, supervision, and regular examination by the California Department of Financial Institutions (CDFI) and the Federal Deposit Insurance Corporation (FDIC). The regulations of these agencies govern most aspects of the Bank's business. The financial statements of the Bank are prepared in conformity with generally accepted accounting principle and general practice within the banking industry. The following is a summary of the significant accounting and reporting policies used in preparing these financial statements.

Nature of Operations: The Bank provides commercial, industrial, agricultural and personal credit and other banking services through its main branch located in Eureka, California.

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

Investment Securities: Securities are classified as held-to-maturity if the Bank has both the intent and ability to hold those debt securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed by the interest method over their contractual lives.

Securities are classified as available-for-sale if the Bank intends to hold those debt securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities held as available-for-sale are carried at fair value. Unrealized holding gains or losses are reported as increases or decreases in shareholders' equity, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.

Loans: Loans are stated at the amount of unpaid principal reduced by net deferred loan fees. Loan origination fees, net of direct origination costs, are deferred and recognized as an adjustment of the yield on the related loan. Amortization of net deferred loan fees is discontinued when the loan is placed on nonaccrual status. Interest on loans is accrued and credited to income based on the principal amount outstanding.

Allowance for Loan Losses: The allowance is maintained at a level which, in the opinion of management, is adequate to absorb probable losses inherent in the loan portfolio. Credit losses related to off-balance-sheet instruments are included in the allowance for loan losses. Management determines the adequacy of the allowance based upon reviews of individual loans, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. The allowance is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed monthly and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Loans deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

All loans, except those to individuals, are considered impaired, based on current information and events, if it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Allowances on impaired loans are established based on the present value of expected future cash flows discounted at the loan's historical effective interest rate or, for collateral-dependent loans, on the fair value of the collateral. Cash receipts on impaired loans are used to reduce principal.

Income Recognition on Impaired and Nonaccrual Loans: Loans, including those considered impaired, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. If a loan or a portion of a loan is classified as doubtful or is partially charged off, the loan is classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable period of time, and there is a sustained period of repayment performance by the borrower, in accordance with the contractual terms of interest and principal.

While a loan is classified as nonaccrual and the future collectibility of the recorded balance is doubtful, collections of interest and principal are generally applied as a reduction to the principal outstanding. When the future collectibility of the recorded balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded balance at the contractual interest rate. Cash interest receipts in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

Premises and Equipment: Premises and equipment are stated at cost, less accumulated depreciation and amortization. The provision for depreciation and amortization is computed principally by the straight-line method over estimated useful lives of the related assets.

Income Taxes: Provisions for income taxes are based on amounts reported in the statements of operations (after exclusion of non-taxable income such as interest on state and municipal securities) and include deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred taxes are computed using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax basis. 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. Deferred tax assets are recognized for deductible temporary differences and tax credit carryforwards, and then a valuation allowance is established to reduce that deferred tax asset if it is "more likely than not" that the related tax benefits may not be realized.

Net Income Per Share of Common Stock: Net income per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding during the year. Net income per share--assuming dilution is computed similar to net income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Included in the denominator is the dilutive effect of stock options computed under the treasury method.

Advertising: Advertising costs are charged to operations in the year incurred.

Off-Balance-Sheet Financial Instruments: In the ordinary course of business the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the financial statements when they become payable.

NOTE A--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Option Accounting: The Bank has a stock-based employee and director compensation plan which is described more fully in Note L. The Bank applies Statement of Financial Accounting Standard (SFAS) No. 123, *Share-Based Payment* accounting for its plans. Accordingly, compensation cost for stock options is measured based on the grant-date fair value and is recognized in the income statement.

Operating Segments: Reportable segments are based on products and services, geography, legal structure, management structure and any other manner in which management desegregates a company for making operating decisions and assessing performance. The Bank has determined that its business is comprised of a single operating segment.

Cash and Cash Equivalents: For the purpose of presentation in the Statement of Cash Flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "Cash and due from banks" and “Federal funds sold.”

NOTE B--RESTRICTIONS ON CASH AND DUE FROM BANKS

Cash and due from banks include amounts the Bank is required to maintain to meet certain average reserve requirements of the Federal Reserve Bank. The total requirement at December 31, 2005 and 2004 was $323,000 and $102,000, respectively.

NOTE C--INVESTMENT SECURITIES

The amortized cost and approximate fair value of investment securities are summarized as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities Available-for Sale				
December 31, 2005:				
U.S. government agency securities	$ 10,494,230		$(124,134)	$ 10,370,096
Mortgage-backed securities	3,267,651		(61,274)	3,206,377
	$ 13,761,881		$(185,408)	$ 13,576,473
December 31, 2004:				
U.S. government agency securities	$ 7,993,931	$ 846	$ (45,277)	$ 7,949,500
Mortgage-backed securities	2,753,507	27,886	(3,589)	2,777,804
	$ 10,747,438	$ 28,732	$ (48.866)	$ 10,727,304

The maturities of investment securities at December 31, 2005 were as follows:

	Available-for-Sale	
	Amortized Cost	Fair Value
Due in one year or less	$ 2,499,961	$ 2,478,377
Due from one year to five years	8,689,902	8,567,939
Due from five years to ten years	2,572,018	2,530,157
	$ 13,761,881	$ 13,576,473

NOTE C--INVESTMENT SECURITIES (Continued)

The amortized cost and fair value of mortgage-backed securities are presented by contractual maturity in the preceding table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations without call or prepayment penalties.

There were no sales of investment securities during 2005 or 2004.

The following table shows the investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2005 and 2004.

	2005			
	Less Than 12 Months		Greater Than 12 Months	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government agency securities	$ 6,933,846	$ 60,535	$ 3,436,250	$ 63,599
Mortgage-backed securities	2,534,157	37,861	672,220	23,413
	$ 9,468,003	$ 98,396	$ 4,108,470	$ 87,012

	2004	
	Less Than 12 Months	
Description of Securities	Fair Value	Unrealized Losses
U.S. government agency securities	$ 6,449,188	$ 45,277
Mortgage-backed securities	882,386	3,589
	$ 7,331,574	$ 48,866

There were six U.S. government agency securities and one mortgage-backed security that were in an unrealized loss position for twelve months or more and seven U.S. government agency securities and two mortgage-backed securities that were in an unrealized loss position for less than twelve months as of December 31, 2005. There were eight U.S. government agency securities and one mortgage-backed security that were in a loss position twelve months or less as of December 31, 2004. The unrealized losses on these securities were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the par value of the investment. Because the Bank has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2005 and 2004.

NOTE D--LOANS, NET

Major classifications of loans at December 31, 2005 and 2004 are summarized as follows:

	2005	2004
Real estate—mortgage	$ 12,975,528	$ 4,722,046
Real estate—commercial	25,186,276	11,867,825
Commercial	7,163,746	2,444,263
Agricultural	1,177,173	
Installment and other loans to individuals	8,996,122	4,118,644
	55,498,845	23,152,778
Net deferred loan fees and costs	(146,477)	(46,285)
Allowance for loan losses	(725,000)	(350,000)
	$ 54,627,368	$ 22,756,493

The allowance for loan losses was $725,000 and $350,000 as of December 31, 2005 and 2004, respectively. The provision for loan losses was $375,000 and $350,000 as of December 31, 2005 and 2004, respectively. There were no charge offs or recoveries for the year ended December 31, 2005 and period ended December 31, NO2004. There were no impaired or nonaccrual loans at December 31, 2005 and 2004.

The maturity and repricing of the loan portfolio is as follows at December 31:

	2005	2004
Fixed rate loan maturities		
Three months or less	$ 161,786	$ 33,286
Over three months to twelve months	4,189,674	1,243,043
Over one year to five years	3,789,994	786,392
Over five years to fifteen years	3,486,877	1,373,713
Over fifteen years	951,280	78,275
Floating rate loans repricing		
Quarterly or more frequently	35,351,785	16,099,978
Quarterly to annual frequency	1,799,162	2,345,386
One to five years frequency	4,541,216	1,192,705
Five to fifteen years frequency	1,227,071	
	$ 55,498,845	$ 23,152,778

NOTE E--PREMISES AND EQUIPMENT

Premises and equipment consisted of the following at December 31:

	2005	2004
Land	$ 400,000	$ 400,000
Building and improvements	1,648,445	1,631,271
Furniture, fixtures and equipment	718,584	615,949
	2,767,029	2,647,220
Less: Accumulated depreciation	(346,689)	(132,202)
	$ 2,420,340	$ 2,515,018

Depreciation and amortization included in occupancy expense totaled $214,487 in 2005 and $132,202 in 2004.

NOTE F--INTEREST-BEARING DEPOSITS

Interest-bearing deposits consisted of the following at December 31:

	2005	2004
Negotiable order of withdrawal (NOW)	$ 13,418,278	$ 8,698,811
Savings and money markets	30,219,902	20,123,463
Time, $100,000 and over	8,461,448	3,139,324
Other time	3,496,289	1,064,875
	$ 55,595,917	$ 33,026,473

Interest expense on these deposits for the year ended December 31, 2005 and the period ended December 31, 2004 is as follows:

	2005	2004
NOW	$ 154,947	$ 29,607
Savings and money markets	460,725	145,777
Time, $100,000 and over	163,973	15,917
Other time	59,677	9,243
	$ 839,322	$ 200,544

The maturities of time deposits at December 31, 2005 and 2004 are as follows:

	2005	2004
Three months or less	$ 3,527,431	$ 643,098
Over three months through twelve months	6,889,232	2,241,323
Over one year through three years	1,533,855	1,025,198
Over three years	7,219	294,580
	$ 11,957,737	$ 4,204,199

NOTE G--LENDING AGREEMENTS

The Bank has federal funds line of credit agreements with other banks. The maximum borrowings available under these lines amount to $7,500,000 and $3,500,000 at December 31, 2005 and 2004, respectively. There were no borrowings outstanding under these agreements at December 31, 2005 and 2004.

The Bank has an agreement to borrow from the Federal Home Loan Bank to the extent of pledged assets, up to 15% of total assets. Assets pledged under the agreement at December 31, 2005 totaled $81,199,269, resulting in a limit on borrowings of $12,179,890. Assets pledged under the agreement at December 31, 2004 totaled $52,161,573, resulting in a limit on borrowings of $7,824,236. There were no borrowings outstanding under this agreement as of December 31, 2005 and 2004.

NOTE H--OTHER EXPENSES

Other expenses consisted of the following for the year ended December 31, 2005 and the period ended December 31, 2004:

	2005	2004
Pre-opening expense		$ 810,786
Professional fees	$ 214,547	264,023
Data processing	203,350	190,065
Marketing and promotion	161,046	110,205
Director and shareholder	80,615	100,462
Operating expense	110,500	76,730
Insurance expense	95,448	65,094
Loan and collection expense	56,511	64,437
Stationery and forms	62,382	61,958
Miscellaneous employee expense	55,169	31,225
Telephone expense	21,765	17,538
Operational losses	9,235	14,118
Dues and memberships	18,707	12,615
Postage and delivery	18,453	11,699
Miscellaneous processing/administration fees	3,910	4,373
Subscriptions	8,912	3,087
Security expense	2,188	1,021
.	$ 1,122,738	$ 1,839,436

NOTE I--RETIREMENT PLANS

The Bank has a defined contribution retirement plan covering substantially all of the Bank's employees. Employees may elect to have a portion of their compensation contributed to the plan in conformity with the requirements of Section 401(k) of the Internal Revenue Code. The Bank will make contributions equal to 100% of the effective deferral made by the employees, up to a maximum of 4% of the employees eligible earnings. Salaries and employee benefits expense includes Bank contributions to the plan of $45,027 during 2005 and $38,800 during 2004.

NOTE J--INCOME TAXES

Income tax expense included in the statement of operations consisted of $800 and $1,600 of current state tax paid for the year ended December 31, 2005 and the period ended December 31, 2004, respectively. The following is a reconciliation of income taxes computed at the Federal statutory rate of 34% to the effective rate used for the provision for income taxes for the year ended December 31, 2005 and the period ended December 31, 2004.

NOTE J--INCOME TAXES (Continued)

	2005	2004
Income benefit at the Federal statutory rate	$ (105,566)	$ (922,763)
State franchise tax benefit, less Federal income tax effect	(22,213)	(194,171)
Interest on enterprise zone loans exempt from State tax	(20,794)	(3,699)
Enterprise zone business deduction	(1,431)	(2,862)
Valuation allowance change	124,869	1,098,264
Incentive stock option expense	19,720	19,719
Nondeductible expenses and other	6,215	7,112
Provision for income tax	$ 800	$ 1,600

The expected tax expense shown above that would result from applying Federal and State statutory rates to the pretax loss differs from amounts reported in the financial statements primarily because the valuation allowance increased to offset the impact of operating loss carryforwards and other temporary differences until such time as realization becomes more likely than not. The tax effects of temporary differences that give rise to the components of the net deferred tax assets as of December 31 were as follows:

	2005	2004
Deferred tax assets:		
Net operating loss and contribution carryforwards	$ 995,600	$ 957,098
Start-up costs	159,233	208,229
Organizational costs	56,005	73,237
Nonstatutory stock option expense	39,447	18,710
Allowance for loan losses	36,831	
Adjustment to cash basis	22,411	
Contribution carryforwards	9,419	1,833
Total deferred tax assets	1,318,946	1,259,107
Valuation allowance for deferred tax assets	(1,223,133)	(1,098,264)
Deferred tax assets recognized	95,813	160,843
Deferred tax liabilities:		
Depreciation	88,304	104,700
Discount accretion	5,904	3,478
Other	1,605	
Allowance for loan losses		34,244
Adjustment to cash basis		18,421
Total deferred tax liabilities	95,813	160,843
Net deferred tax assets	$ -	$ -

Amounts presented for the tax effects of temporary differences are based upon estimates and assumptions and could vary from amounts ultimately reflected on the Bank's tax returns. Accordingly, the variances from amounts reported in prior years are primarily adjustments to conform to the tax returns as filed. The Bank had income tax payable of $800 at December 31, 2005. The Bank had no income taxes receivable or payable at December 31, 2004.

NOTE J--INCOME TAXES (Continued)

As of December 31, 2005, the Bank has federal and state net operating loss carryforwards available to reduce future taxable income as follows:

	Net Operating Loss Carryforward	Expiration Date
Federal	$ 2,369,731	2024
	23,863	2025
	$ 2,393,594	
State	$ 2,116,034	2014
	424,757	2015
	$ 2,540,791	

As of December 31, 2005, the Bank also has federal and state contribution carryforwards of $22,885, which expire in 2009 through 2010.

NOTE K--EARNINGS PER SHARE

The following is a computation of basic and diluted earnings per share for the year ended December 31, 2005 and the period ended December 31, 2004:

	2005	2004
Basic:		
Net loss	$ (311,285)	$ (2,714,008)
Weighted-average common shares outstanding	1,101,770	1,100,000
Earnings per share	$ (.28)	$ (2.47)
Diluted:		
Net loss	$ (311,287)	$ (2,714,008)
Weighted-average common shares outstanding	1,101,770	1,100,000
Net effect of dilutive stock options – based on the treasury stock method using average market price	98,387	75,442
Weighted-average common shares outstanding and common stock equivalents	1,200,157	1,175,442
Earnings per share - assuming dilution	$ (.26)	$ (2.31)

NOTE L--STOCK OPTION PLAN

The Bank has a stock option plan established in 2004 under which incentive and nonstatutory stock options, as defined under the Internal Revenue Code, may be granted. The Bank's Stock Option Plan provides for the granting of a maximum of 330,000 shares of the Bank's common stock to directors, key employees and consultants at an exercise price not less than the fair market value of the shares on the date of grant and for a term of no more than 10 years. Options granted vest at a rate of 20% per year over five years from the date the option is granted. Generally, if an optionee's continuous status as a director, employee or consultant is terminated for various reasons, the non-vested options expire.

The fair value of options granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2005 and 2004: dividend yield of zero; risk-free interest rate of 4.18 percent for 2005 and 4.26 percent for 2004 and expected life of 10 years. Compensation expense related to stock option grants totaled $98,304 for the year ended December 31, 2005 and $93,378 for the period ended December 31, 2004.

A summary of stock option activity during the year ended December 31, 2005 and period ended December 31, 2004 follows:

	Incentive Stock Options			
	2005		2004	
	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares
Shares under option at beginning of year	$ 10.00	105,000		
Options granted			$ 10.00	105,000
Options exercised	10.00	(2,000)		
Shares under option at end of year	10.00	103,000	10.00	105,000
Options exercisable at end of year		36,535		21,000
Weighted-average fair value of options granted during the year			2.28	

	Nonstatutory Stock Options			
	2005		2004	
	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares
Shares under option at beginning of year	$ 10.00	99,625		
Options granted	20.00	11,000	$ 10.00	99,625
Shares under option at end of year	10.99	110,625	$ 10.00	99,625
Options exercisable at end of year		37,482		19,925

NOTE L--STOCK OPTION PLAN (Continued)

	Nonstatutory Stock Options			
	2005		2004	
	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares
Weighted-average fair value of options granted during the year	$ 4.48		$ 2.28	

The following table summarizes information about fixed stock options outstanding at December 31, 2005:

	Options Outstanding		
Exercise Price	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$10.00	202,625	8.12 years	$10.00
$20.00	11,000	9.54 years	20.00
	213,625	8.26 years	10.51

	Options Exercisable	
Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$10.00	73,098	$10.00
$20.00	919	20.00
	74,017	10.12

NOTE M--RELATED PARTY TRANSACTIONS

During the normal course of business, the Bank has entered into transactions with its directors, executive officers, significant shareholders and their affiliates (related parties). The aggregate amount of loans to such related parties totaled $986,733 and $1,824,528 at December 31, 2005 and 2004, respectively. At December 31, 2005 and 2004, commitments to related parties of $1,071,057 and $860,472, respectively, were undisbursed. The Bank has received deposits from directors and officers and their related interests totaling $2,448,591 and $4,480,369 at December 31, 2005 and 2004, respectively.

The Bank leased its facility from a director under an operating lease that included an option to purchase. Lease payments during 2004 totaled $51,304. The Bank exercised the option in 2004 and purchased its facility at fair market value from the director for $1,440,953.

The organizers and directors advanced approximately $420,682 to the Bank for the payment of the Bank's initial organization, stock offering and pre-opening expenses, for which they were reimbursed.

NOTE N--CONTINGENT LIABILITIES AND COMMITMENTS

Financial Instruments with Off-Balance-Sheet Risk: The Bank's financial statements do not reflect various commitments and contingent liabilities which arise in the normal course of business and which involve elements of credit risk, interest rate risk and liquidity risk. These commitments and contingent liabilities are commitments to extend credit. The Bank's commitments and contingent liabilities consisted of commitments to extend credit of $26,218,121 and $10,906,057 at December 31, 2005 and 2004, respectively.

Commitments to extend credit include exposure to some credit loss in the event of nonperformance of the customer. The Bank's credit policies and procedures for credit commitments and financial guarantees are the same as those for extension of credit that are recorded on the balance sheet. Because most of these instruments have fixed maturity dates, and because many of them expire without being drawn upon, they do not generally present any significant liquidity risk to the Bank.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, deeds of trust on residential real estate and income-producing commercial properties.

The Bank did not incur any losses on its commitments in 2005 and 2004.

NOTE O--CONCENTRATIONS OF CREDIT RISK

Most of the Bank's business activity is with customers located within the State of California, primarily in and around the City of Eureka. Most of the Bank's loans have been granted to customers in the Bank's market area. General economic conditions or natural disasters affecting the primary market area could affect the ability of customers to repay loans and the value of real property used as collateral. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers. The Bank requires that all loans have adequate collateral to secure the loan or that the borrower has evidence of sufficient cash flows to repay loans when the loans are made. All collateral must have an appraisal, if applicable, and collateral is generally secured by liens. The Bank's access to this collateral is through judicial procedures.

The concentrations of credit by type of loan are set forth in Note D. Approximately 69% of the Bank's loans are collateralized by real estate in the Bank's service area. The National Banking Laws, Title 12 of the United States Code, generally restricts loans to a single borrower or group of related borrowers and investments by the Bank to 15% of the sum of the Bank's equity capital plus the allowance for loan losses, subject to certain adjustments. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include residential and commercial real property, marketable securities, accounts receivable, inventory, equipment and savings accounts.

The concentrations by type of investment security are set forth in Note C. The Bank places its investments primarily in financial instruments backed by the U.S. Government and its agencies. In addition, at December 31, 2005 and 2004, the Bank had deposits in federally insured banks in excess of federally insured limits by $42,474 and $97,569, respectively.

At December 31, 2005, approximately 16% of the Bank's deposits were from five depositors. Management monitors these accounts and maintains close contact with these depositors to minimize the impact on the Bank's liquidity.

NOTE P--REGULATORY MATTERS

The Bank is subject to the dividend restrictions set forth by the FDIC. Under such restrictions, the Bank may not, without the prior approval of the FDIC, declare dividends in excess of the sum of the current year's net income plus the retained earnings from the prior two years. As of December 31, 2005, the Bank could not make a cash dividend distribution without prior approval.

The Bank is subject to various regulatory capital requirements administered by its primary federal regulator, the FDIC. 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 I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2005, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2005, the most recent notification from the FDIC 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 I risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. The Bank's actual 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
			(in thousands)			
As of December 31, 2005:						
Total Capital (to Risk Weighted Assets)	$ 8,830	14.57%	≥$ 4,848	≥ 8.00 %	≥$ 6,060	≥ 10.00 %
Tier I Capital (to Risk Weighted Assets)	$ 8,138	13.43%	≥$ 2,424	≥ 4.00 %	≥$ 3,636	≥ 6.00 %
Tier I Capital (to Average Assets)	$ 8,138	10.42%	≥$ 3,123	≥4.00 %	≥$ 3,904	≥ 5.00 %
As of December 31, 2004:						
Total Capital (to Risk Weighted Assets)	$ 8,612	28.04%	≥$ 2,457	≥ 8.00 %	≥$ 3,072	≥ 10.00 %
Tier I Capital (to Risk Weighted Assets)	$ 8,262	26.90%	≥$ 1,229	≥ 4.00 %	≥$ 1,843	≥ 6.00 %
Tier I Capital (to Average Assets)	$ 8,262	17.61%	≥$ 1,876	≥4.00 %	≥$ 2,345	≥ 5.00 %