

FIRST NORTHERN COMMUNITY BANCORP
Form 10-K
March 15, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission File Number 000-30707

First Northern Community Bancorp

(Exact name of Registrant as specified in its charter)

California
(State or other jurisdiction of incorporation or
organization)

68-0450397
(I.R.S. Employer Identification Number)

195 N. First St., Dixon, CA
(Address of principal executive offices)

95620
(Zip Code)

707-678-3041

(Registrant's telephone number including area code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the Common Stock held by non-affiliates of the registrant on June 30, 2006 (based upon the last reported sales price of such stock on the OTC Bulletin Board on June 30, 2006) was \$209,686,313.

The number of shares of Common Stock outstanding as of March 13, 2007 was 7,958,805.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12 (as to security ownership of certain beneficial owners and management), 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2007 Annual Meeting of Shareholders.

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This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are subject to the “safe harbor” created by those sections. Forward-looking statements include the information concerning possible or assumed future results of operations of the Company set forth under the heading “Management's Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Often they include words such as “expect,” “anticipate,” “intend,” “plan,” “believe,” “estimate,” “consider,” or words of similar meaning, or future or conditional verbs such as “will,” “would,” “should,” “could,” “might,” or “may. These forward-looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the risks discussed in Item 1A under the caption “Risk Factors” and other risk factors discussed elsewhere in this Report. All of these forward-looking statements are based on assumptions about an uncertain future and are based on information available to us at the date of these statements. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

PART I

ITEM 1 - BUSINESS

Unless otherwise indicated, all information herein has been adjusted to give effect to our two-for-one stock split in 2005 and stock dividends.

First Northern Bank of Dixon (“First Northern” or the “Bank”) was established in 1910 under a California state charter as Northern Solano Bank, and opened for business on February 1st of that year. On January 2, 1912, the First National Bank of Dixon was established under a federal charter, and until 1955, the two entities operated side by side under the same roof and with the same management. In an effort to increase efficiency of operation, reduce operating expense, and improve lending capacity, the two banks were consolidated on April 8, 1955, with the First National Bank of Dixon as the surviving entity.

On January 1, 1980, the Bank’s federal charter was relinquished in favor of a California state charter, and the Bank’s name was changed to First Northern Bank of Dixon.

In April of 2000, the shareholders of First Northern approved a corporate reorganization, which provided for the creation of a bank holding company, First Northern Community Bancorp (the “Company”). The objective of this reorganization, which was effected May 19, 2000, was to enable the Bank to better compete and grow in its competitive and rapidly changing marketplace. As a result of the reorganization, the Bank is a wholly owned and principal operating subsidiary of the Company.

First Northern engages in the general commercial banking business in the Solano, Yolo, Placer and Sacramento Counties of California.

The Company’s and the Bank’s Administrative Offices are located in Dixon, California. Also located in Dixon are the back office functions of the Information Services/Central Operations Department and the Central Loan Department.

The Bank has eleven full service branches. Four are located in the Solano County cities of Dixon, Fairfield, and Vacaville (2). Four branches are located in the Yolo County cities of Winters, Davis, West Sacramento and Woodland. Two branches are located in Sacramento County, one in Downtown Sacramento and the other in the city of Folsom, and one branch is located in the city of Roseville in Placer County. The Bank also has two

satellite-banking offices inside retirement communities in the city of Davis. In addition, the Bank has real estate loan offices in Davis, Woodland, Vacaville, Folsom and Roseville that originate residential mortgages and construction loans. The Bank also has a Small Business Administration (the "SBA") Loan Department and an Asset Management & Trust Department in Downtown Sacramento that serve the Bank's entire market area.

First Northern is in the commercial banking business, which includes accepting demand, interest bearing transaction, savings, and time deposits, and making commercial, consumer, and real estate related loans. It also offers installment note collection, issues cashier's checks and money orders, sells travelers' checks, rents safe deposit boxes, and provides other customary banking services. The Bank is a member of the Federal Deposit Insurance Corporation ("FDIC") and each depositor's account is insured up to \$100,000.

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First Northern also offers a broad range of alternative investment products and services. The Bank offers these services through an arrangement with Raymond James Financial Services, Inc., an independent broker/dealer and a member of NASD and SIPC. All investments and/or financial services offered by representatives of Raymond James Financial Services, Inc. are not insured by the FDIC.

The Bank offers equipment leasing and limited international banking services through third parties.

The operating policy of the Bank since its inception has emphasized serving the banking needs of individuals and small-to medium-sized businesses. In Dixon, this has included businesses involved in crop and livestock production. Historically, the economy of the Dixon area has been primarily dependent upon agricultural related sources of income and most employment opportunities have also been related to agriculture. Since 2000, Dixon has been growing and becoming more diverse with noticeable expansion in the areas of industrial, commercial, retail and residential housing projects.

Agriculture continued to be a significant factor in the Bank's business after the opening of the first branch office in Winters in 1970. A significant step was taken in 1976 to reduce the Company's dependence on agriculture with the opening of the Davis Branch.

The Davis economy is supported significantly by the University of California, Davis. In 1981, a branch was opened in South Davis, and was consolidated into the main Davis Branch in 1986.

In 1983, the West Sacramento Branch was opened. The West Sacramento economy is built primarily around transportation and distribution related business. This addition to the Bank's market area further reduced the Company's dependence on agriculture.

In order to accommodate the demand of the Bank's customers for long-term residential real estate loans, a Real Estate Loan Office was opened in 1983. This office is centrally located in Davis, and has enabled the Bank to access the secondary real estate market.

The Vacaville Branch was opened in 1985. Vacaville is a rapidly growing community with a diverse economic base including a California state prison, food processing, distribution, shopping centers (Factory Outlet Stores), medical, biotech and other varied industries.

In 1994, the Fairfield Branch was opened. Fairfield has also been a rapidly growing community bounded by Vacaville on the east. Its diverse economic base includes military (Travis AFB), food processing (an Anheuser-Busch plant), retail (Solano Mall), manufacturing, medical, agriculture, and other varied industries. Fairfield is the county seat of Solano County.

A real estate loan production office was opened in El Dorado Hills, in April 1996, to serve the growing mortgage loan demand in the foothills area east of Sacramento. This office was moved to Folsom in 2006, a more central location for serving Folsom, Rancho Cordova, and the eastern slope of El Dorado County.

The SBA Loan Department was opened in April 1997 in Sacramento to serve the small business and industrial loan demand throughout the Bank's entire market area.

In June of 1997, the Bank's seventh branch was opened in Woodland, the county seat of Yolo County. Woodland is an expanding and diversified city with an economy dominated by agribusiness, retail services, and a healthy industrial sector.

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The Bank's eighth branch, the Downtown Financial Center, opened in July of 2000 in Vacaville to serve the business and individual financial needs on the west side of Interstate-80. Also in July of 2000, in an adjacent office, the Bank opened its third real estate loan production office.

Two satellite banking offices of the Bank's Davis Branch were opened in 2001 in the Davis senior living communities of Covell Gardens and the University Retirement Community.

In December of 2001, Roseville became the site of the Bank's fourth real estate loan production office. This office serves the residential mortgage loan needs throughout Placer County.

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In March of 2002 the Bank opened its ninth branch in a new class-A commercial building located on the harbor in Suisun City. Suisun's Downtown waterfront area is part of an ongoing community revitalization project put into place with the goal of attracting new small businesses and merchants. After five years in operation and slower than anticipated city growth, the Bank decided to close its Suisun City Branch and serve the Branch's customers out of its Fairfield Branch. The Fairfield Branch is undergoing an expansion and remodel to accommodate the additional customers.

In October of 2002, the Bank opened its tenth branch on a prominent corner in Downtown Sacramento to serve Sacramento Metro's business center and its employees. The Bank's Asset Management & Trust Department, located on the mezzanine of the Downtown Sacramento Branch, was opened in 2002 to serve the trust and fiduciary needs of the Bank's entire market area. Fiduciary services are offered to individuals, businesses, governments and charitable organizations in the Solano, Yolo, Sacramento, Placer and El Dorado County regions.

In August of 2003, a fifth full service real estate loan production office was opened in Woodland. This loan office is located within the same commercial office complex as the Bank's Woodland Branch. The Bank's history of servicing the Woodland community, coupled with the continued growth of the Woodland housing market, prompted this decision to expand the Bank's real estate loan services for the community.

The Bank expanded its presence in Placer County in January 2005 by opening a full service branch on a prominent corner in the rapidly growing business district of Roseville.

In the fourth quarter of 2006, the Bank opened its Folsom Financial Center which houses a full service branch, a real estate loan production office, and an investment & brokerage services office. Folsom is one of the fastest growing cities in Sacramento County and its central proximity to Rancho Cordova and El Dorado Hills makes it ideal for building market share in the eastern part of the County.

Through this period of change and diversification, the Bank's strategic focus, which emphasizes serving the banking needs of individuals and small to medium-sized businesses, has not changed. The Bank takes real estate, crop proceeds, securities, savings and time deposits, automobiles, and equipment as collateral for loans.

Most of the Bank's deposits are attracted from the market of northern and central Solano County and southern and central Yolo County. The Company believes that the Bank's deposit base does not involve any undue concentration levels from one or a few major depositors.

As of December 31, 2006, the Company and the Bank employed 242 full-time equivalent staff. The Company and the Bank consider their relationship with their employees to be good and have not experienced any interruptions of operations due to labor disagreements.

First Northern has historically experienced seasonal swings in both deposit and loan volumes due primarily to general economic factors and specific economic factors affecting our customers. Deposits have typically hit lows in February or March and have peaked in November or December. Loans typically peak in the late spring and hit lows in the fall as crops are harvested and sold. Since the real estate and agricultural economies generally follow the same seasonal cycle, they experience the same deposit and loan fluctuations.

Available Information

The Company's internet address is www.thatsmybank.com, and the Company makes available free of charge on this website its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after the Company electronically files such material

with, or furnishes it to, the SEC. These filings are also accessible on the SEC's website at www.sec.gov. The information found on the Company's website shall not be deemed incorporated by reference by any general statement incorporating by reference this report into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the information found on the Company's website by reference, and shall not otherwise be deemed filed under such Acts.

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The Effect of Government Policy on Banking

The earnings and growth of the Bank are affected not only by local market area factors and general economic conditions, but also by government monetary and fiscal policies. For example, the Board of Governors of the Federal Reserve System (the “FRB”) influences the supply of money through its open market operations in U.S. Government securities, adjustments to the discount rates applicable to borrowings by depository institutions and others and establishment of reserve requirements against both members and non-members financial institutions’ deposits. Such actions significantly affect the overall growth and distribution of loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact of future changes in such policies on the business and earnings of the Company cannot be predicted. Additionally, state and federal tax policies can impact banking organizations.

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

Regulation and Supervision of Bank Holding Companies

The Company is a bank holding company subject to the Bank Holding Company Act of 1956, as amended (the “BHCA”). The Company reports to, registers with, and may be examined by, the FRB. The FRB also has the authority to examine the Company’s subsidiaries. The costs of any examination by the FRB are payable by the Company.

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

The FRB has significant supervisory and regulatory authority over the Company and its affiliates. The FRB requires the Company to maintain certain levels of capital. *See* “Capital Standards” below for more information. The FRB also has the authority to take enforcement action against any bank holding company that commits any unsafe or unsound practice, or violates certain laws, regulations or conditions imposed in writing by the FRB. *See* “Prompt Corrective Action and Other Enforcement Mechanisms” below for more information. According to FRB policy, bank holding companies are expected to act as a source of financial strength to subsidiary banks, and to commit resources to support subsidiary banks. This support may be required at times when a bank holding company may not be able to provide such support.

Under the BHCA, a company generally must obtain the prior approval of the FRB before it exercises a controlling influence over a bank, or acquires directly or indirectly, more than 5% of the voting shares or substantially all of the assets of any bank or bank holding company. Thus, the Company is required to obtain the prior approval of the FRB before it acquires, merges or consolidates with any bank or bank holding company. Any company seeking to acquire, merge or consolidate with the Company also would be required to obtain the prior approval of the FRB.

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

the proposed activity will outweigh the possible adverse effects associated with such activity.

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The Gramm-Leach-Bliley Act of 1999 (“GLBA”) eliminated many of the restrictions placed on the activities of bank holding companies that become financial holding companies. Among other things, GLBA repealed certain Glass-Steagall Act restrictions on affiliations between banks and securities firms, and amended the BHCA to permit bank holding companies that are financial holding companies to engage in activities, and acquire companies engaged in activities, that are: financial in nature (including insurance underwriting, insurance company portfolio investment, financial advisor, securities underwriting, dealing and market-making, and merchant banking activities); incidental to financial activities; or complementary to financial activities if the FRB determines that they pose no substantial risk to the safety or soundness of depository institutions or the financial system in general. The Company has not become a financial holding company. GLBA also permits national banks to engage in activities considered financial in nature through a financial subsidiary, subject to certain conditions and limitations and with the approval of the Comptroller of the Currency.

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

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

The FRB generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a bank holding company's financial position. The FRB's policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. The Company is also subject to restrictions relating to the payment of dividends under California corporate law. See “Restrictions on Dividends and Other Distributions” below for additional restrictions on the ability of the Company and the Bank to pay dividends.

Transactions between the Company and the Bank are subject to a number of other restrictions. FRB policies forbid the payment by bank subsidiaries of management fees, which are unreasonable in amount or exceed the fair market value of the services rendered (or, if no market exists, actual costs plus a reasonable profit). Subject to certain limitations, depository institution subsidiaries of bank holding companies may extend credit to, invest in the securities of, purchase assets from, or issue a guarantee, acceptance, or letter of credit on behalf of, an affiliate, provided that the aggregate of such transactions with affiliates may not exceed 10% of the capital stock and surplus of the institution, and the aggregate of such transactions with all affiliates may not exceed 20% of the capital stock and surplus of such institution. The Company may only borrow from depository institution subsidiaries of the Company if the loan is secured by marketable obligations with a value of a designated amount in excess of the loan. Further, the Company

may not sell a low-quality asset to the Bank.

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Bank Regulation and Supervision

The Bank is subject to regulation, supervision and regular examination by the California Department of Financial Institutions (“DFI”) and the FDIC and the Company by the FRB. The regulations of these agencies affect most aspects of the Company’s business and prescribe permissible types of loans and investments, the amount of required reserves, requirements for branch offices, the permissible scope of the Company’s activities and various other requirements. While the Bank is not a member of the FRB, it is also directly subject to certain regulations of the FRB dealing primarily with check clearing activities, establishment of banking reserves, Truth-in-Lending (Regulation Z), Truth-in-Savings (Regulation DD), and Equal Credit Opportunity (Regulation B). In addition, the banking industry is subject to significantly increased regulatory scrutiny and enforcement regarding Bank Secrecy Act and anti-money laundering matters. In recent years, a number of banks and bank holding companies announced the imposition of regulatory sanctions, including regulatory agreements and cease and desist orders and, in some cases, fines and penalties by the bank regulators due to failures to comply with the Bank Secrecy Act and other anti-money laundering legislation. In a number of these cases, the fines and penalties have been significant.

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

California law permits a state chartered bank to invest in the stock and securities of other corporations, subject to a state chartered bank receiving either general authorization or, depending on the amount of the proposed investment, specific authorization from the Commissioner. Federal banking laws, however, impose limitations on the activities and equity investments of state chartered, federally insured banks. The FDIC rules on investments prohibit a state bank from acquiring an equity investment of a type, or in an amount, not permissible for a national bank. Non-permissible investments must have been divested by state banks no later than December 19, 1996. FDIC rules also prohibit a state bank from engaging as a principal in any activity that is not permissible for a national bank, unless the bank is adequately capitalized and the FDIC approves the activity after determining that such activity does not pose a significant risk to the deposit insurance fund. The FDIC rules on activities generally permit subsidiaries of banks, without prior specific FDIC authorization, to engage in those activities that have been approved by the FRB for bank holding companies because such activities are so closely related to banking to be a proper incident thereto. Other activities generally require specific FDIC prior approval and the FDIC may impose additional restrictions on such activities on a case-by-case basis in approving applications to engage in otherwise impermissible activities.

The USA Patriot Act

Title III of the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA Patriot Act”) includes numerous provisions for fighting international money laundering and blocking terrorism access to the U.S. financial system. The USA Patriot Act requires certain additional due diligence and record keeping practices, including, but not limited to, new customers, correspondent and private banking accounts. In March 2006, President Bush signed into law a renewal of the USA Patriot Act.

Part of the USA Patriot Act is the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (“IMLAFATA”). Among its provisions, IMLAFATA requires each financial institution to: (i) establish an anti-money laundering program; (ii) establish appropriate anti-money laundering policies, procedures and controls; (iii) appoint a Bank Secrecy Act officer responsible for day-to-day compliance; and (iv) conduct independent audits. In addition, IMLAFATA contains a provision encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. IMLAFATA expands the circumstances under which funds in a bank account may be forfeited and requires covered financial institutions to

respond under certain circumstances to requests for information from federal banking agencies within 120 hours. IMLAFATA also amends the BHCA and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these Acts.

Pursuant to IMLAFATA, the Secretary of the Treasury, in consultation with the heads of other government agencies, has adopted and proposed special measures applicable to banks, bank holding companies, and/or other financial institutions. These measures include enhanced record keeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions.

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Privacy Restrictions

GLBA, in addition to the previous described changes in permissible non-banking activities permitted to banks, bank holding companies and financial holding companies, also requires financial institutions in the U.S. to provide certain privacy disclosures to customers and consumers, to comply with certain restrictions on the sharing and usage of personally identifiable information, and to implement and maintain commercially reasonable customer information safeguarding standards.

The Company believes that it complies with all provisions of GLBA and all implementing regulations, and the Bank has developed appropriate policies and procedures to meet its responsibilities in connection with the privacy provisions of GLBA.

California and other state legislatures have adopted privacy laws, including laws prohibiting sharing of customer information without the customer's prior permission. These laws may make it more difficult for the Company to share information with its marketing partners, reduce the effectiveness of marketing programs, and increase the cost of marketing programs.

Capital Standards

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

In determining the capital level the Bank is required to maintain, the federal banking agencies do not, in all respects, follow generally accepted accounting principles ("GAAP") and have special rules which have the effect of reducing the amount of capital that will be recognized for purposes of determining the capital adequacy of the Bank.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off balance sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, non-cumulative perpetual preferred stock, trust preferred securities (for up to 25% of total tier 1 capital), other types of qualifying preferred stock and minority interests in certain subsidiaries, less most other intangible assets and other adjustments. Net unrealized losses on available-for-sale equity securities with readily determinable fair value must be deducted in determining Tier 1 capital. For Tier 1 capital purposes, deferred tax assets that can only be realized if an institution earns sufficient taxable income in the future are limited to the amount that the institution is expected to realize within one year, or 10% of Tier 1 capital, whichever is less. Tier 2 capital may consist of a limited amount of the allowance for possible loan and lease losses, term preferred stock and other types of preferred stock and trust preferred securities not qualifying as Tier 1 capital, term subordinated debt and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital are subject to certain other requirements and limitations of the federal banking agencies. The federal banking agencies require a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to adjusted average risk-adjusted assets and off-balance-sheet items of 4%.

Under FDIC regulations, there are also two rules governing minimum capital levels that FDIC-supervised banks must maintain against the risks to which they are exposed. The first rule makes risk-based capital standards consistent for two types of credit enhancements (i.e., recourse arrangements and direct credit substitutes) and requires different amounts of capital for different risk positions in asset securitization transactions. The second rule permits limited amounts of unrealized gains on debt and equity securities to be recognized for risk-based capital purposes as of September 1, 1998. The FDIC rules also provide that a qualifying institution that sells small business loans and leases with recourse must hold capital only against the amount of recourse retained. In general, a qualifying institution is one that is well capitalized under the FDIC's prompt corrective action rules. The amount of recourse that can receive the preferential capital treatment cannot exceed 15% of the institution's total risk-based capital.

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Effective January 1, 2002, the federal banking agencies, including the FDIC, adopted new regulations to change their regulatory capital standards to address the treatment of recourse obligations, residual interests and direct credit substitutes in asset securitizations that expose banks primarily to credit risk. Capital requirements for positions in securitization transactions are varied according to their relative risk exposures, while limited use is permitted of credit ratings from rating agencies, a banking organization's qualifying internal risk rating system or qualifying software. The regulation requires a bank to deduct from Tier 1 capital, and from assets, all credit-enhancing interest only-strips, whether retained or purchased that exceed 25% of Tier 1 capital. Additionally, a bank must maintain dollar-for-dollar risk-based capital for any remaining credit-enhancing interest-only strips and any residual interests that do not qualify for a ratings-based approach. The regulation specifically reserves the right to modify any risk-weight, credit conversion factor or credit equivalent amount, on a case-by-case basis, to take into account any novel transactions that do not fit well into the currently defined categories.

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

As of December 31, 2006, the Company's and the Bank's capital ratios exceeded applicable regulatory requirements.

The following tables present the capital ratios for the Company and the Bank, compared to the standards for well-capitalized bank holding companies and depository institutions, as of December 31, 2006 (amounts in thousands except percentage amounts).

	The Company				
	Capital	Actual	Ratio	Well Capitalized Ratio	Minimum Capital Requirement
Leverage	\$	62,400	9.1%	5.0%	4.0%
Tier 1 Risk-Based		62,400	11.1%	6.0%	4.0%
Total Risk-Based		69,078	12.3%	10.0%	8.0%

	The Bank				
	Capital	Actual	Ratio	Well Capitalized Ratio	Minimum Capital Requirement
Leverage	\$	61,719	9.0%	5.0%	4.0%
Tier 1 Risk-Based		61,719	11.0%	6.0%	4.0%
Total Risk-Based		68,397	12.2%	10.0%	8.0%

The federal banking agencies must take into consideration concentrations of credit risk and risks from non-traditional activities, as well as an institution's ability to manage those risks, when determining the adequacy of an institution's

capital. This evaluation will be made as a part of the institution's regular safety and soundness examination. The federal banking agencies must also consider interest rate risk (when the interest rate sensitivity of an institution's assets does not match the sensitivity of its liabilities or its off-balance-sheet position) in evaluating a Bank's capital adequacy.

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Prompt Corrective Action and Other Enforcement Mechanisms

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) requires each federal banking agency to take prompt corrective action to resolve the problems of insured depository institutions, including but not limited to those that fall below one or more prescribed minimum capital ratios. The law required each federal banking agency to promulgate regulations defining the following five categories in which an insured depository institution will be placed, based on the level of its capital ratios: well capitalized, adequately capitalized, under-capitalized, significantly undercapitalized and critically undercapitalized.

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

<p><u>“Well capitalized”</u> Total risk-based capital of 10%; Tier 1 risk-based capital of 6%; and Leverage ratio of 5%.</p>	<p><u>“Adequately capitalized”</u> Total risk-based capital of 8%; Tier 1 risk-based capital of 4%; and Leverage ratio of 4%.</p>
<p><u>“Undercapitalized”</u> Total risk-based capital less than 8%; Tier 1 risk-based capital less than 4%; or Leverage ratio less than 4%.</p>	<p><u>“Significantly undercapitalized”</u> Total risk-based capital less than 6%; Tier 1 risk-based capital less than 3%; or Leverage ratio less than 3%.</p>
<p><u>“Critically undercapitalized”</u> Tangible equity to total assets less than 2%.</p>	

An institution that, based upon its capital levels, is classified as “well capitalized,” “adequately capitalized” or “under-capitalized” may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. Management believes that at December 31, 2006, the Company and the Bank met the requirements for “well capitalized institutions.”

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

Safety and Soundness Standards

FDICIA also implemented certain specific restrictions on transactions and required federal banking regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, restricts the use of brokered deposits, limits the aggregate extensions of credit by a depository institution to an executive officer, director, principal shareholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

The federal banking agencies may require an institution to submit to an acceptable compliance plan as well as have the flexibility to pursue other more appropriate or effective courses of action given the specific circumstances and severity of an institution's non-compliance with one or more standards.

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Restrictions on Dividends and Other Distributions

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

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

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

Premiums for Deposit Insurance

The Bank is a member of the Deposit Insurance Fund (DIF) maintained by the FDIC. Through the DIF, the FDIC insures the deposits of the Bank up to prescribed limits for each depositor. The DIF was formed March 31, 2006, upon the merger of the Bank Insurance Fund and the Savings Insurance Fund in accordance with the Federal Deposit Insurance Reform Act of 2005. To maintain the DIF, member institutions are assessed an insurance premium based on their deposits and their institutional risk category. The FDIC determines an institution's risk category by combining its supervisory ratings with its financial ratios and other risk measures.

To offset assessments, a member institution may apply certain one time credits, based on the institution's (or its successor's) assessment base as of the end of 1996. An institution may apply available credits up to 100% of assessments in 2007, and up to 90% of assessments in each of 2008, 2009 and 2010. Based on available credits, we expect the increase in total deposit insurance expense in 2007 under the new assessment schedule to be fully offset.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution's regulatory agency. The termination of deposit insurance for the Bank would have a material adverse effect on our business and prospects.

The Deposit Insurance Funds Act of 1996 (the "Deposit Funds Act") separated the Financing Corporation ("FICO") assessment to service the interest on FICO bond obligations from the BIF and Savings Association Insurance Fund ("SAIF") assessments. The FICO annual assessment on individual depository institutions is in addition to the amount, if any, paid for deposit insurance according to the FDIC's risk-based assessment rate schedules. FICO assessment rates may be adjusted quarterly by the FDIC. The current FICO assessment rate is 1.32 cents per \$100 of deposits. In addition, the FDIC has authority to impose special assessments from time to time, subject to certain limitations specified in the Deposit Funds Act.

Community Reinvestment Act and Fair Lending

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

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Sarbanes - Oxley Act

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act of 2002. This legislation addressed accounting oversight and corporate governance matters among public companies, including:

- the creation of a five-member oversight board that sets standards for accountants and has investigative and disciplinary powers;
 - the prohibition of accounting firms from providing various types of consulting services to public clients and requires accounting firms to rotate partners among public client assignments every five years;
 - increased penalties for financial crimes;
 - expanded disclosure of corporate operations and internal controls and certification of financial statements;
 - enhanced controls on, and reporting of, insider trading; and
- prohibition on lending to officers and directors of public companies, although the Bank may continue to make these loans within the constraints of existing banking regulations.

Among other provisions, Section 302(a) of the Sarbanes-Oxley Act requires that our Chief Executive Officer and Chief Financial Officer certify that our quarterly and annual reports do not contain any untrue statement or omission of a material fact. Specific requirements of the certifications include having these officers confirm that they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our disclosure controls and procedures; they have made certain disclosures to our auditors and Audit Committee about our internal controls; and they have included information in our quarterly and annual reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to their evaluation.

In addition, Section 404 of the Sarbanes-Oxley Act and the SEC's rules and regulations thereunder require our management to evaluate, with the participation of our principal executive and principal financial officers, the effectiveness, as of the end of each fiscal year, of our internal control over financial reporting. Our management must then provide a report of management on our internal control over financial reporting that contains, among other things, a statement of their responsibility for establishing and maintaining adequate internal control over financial reporting, and a statement identifying the framework they used to evaluate the effectiveness of our internal control over financial reporting.

Pending Legislation and Regulations

Proposals to change the laws and regulations governing the banking and financial services industry are frequently introduced in Congress, in the state legislatures and before the various bank regulatory agencies. The likelihood and timing of any such changes and the impact such changes might have on the Company cannot be determined at this time.

Competition

In the past, an independent bank's principal competitors for deposits and loans have been other banks (particularly major banks), savings and loan associations and credit unions. For agricultural loans, the Bank also competes with constituent entities with the Federal Farm Credit System. To a lesser extent, competition was also provided by thrift and loans, mortgage brokerage companies and insurance companies. Other institutions, such as brokerage houses, mutual fund companies, credit card companies, and even retail establishments have offered new investment vehicles, which also compete with banks for deposit business. The direction of federal legislation in recent years seems to favor competition among different types of financial institutions and to foster new entrants into the financial services market.

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The enactment of GLBA is the latest evidence of this trend, and it is anticipated that this trend will continue as financial services institutions combine to take advantage of the elimination of the barriers against such affiliations. The enactment of the federal Interstate Banking and Branching Act in 1994 and the California Interstate Banking and Branching Act of 1995 have increased competition within California. Recent legislation has also made it easier for out-of-state credit unions to conduct business in California and allows industrial banks to offer consumers more lending products. Moreover, regulatory reform, as well as other changes in federal and California law will also affect competition. The availability of banking services over the Internet or “e-banking” has continued to expand. While the impact of these changes, and of other proposed changes, cannot be predicted with certainty, it is clear that the business of banking in California will remain highly competitive.

In order to compete with major financial institutions and other competitors in its primary service areas, the Bank relies upon the experience of its executive and senior officers in serving business clients, and upon its specialized services, local promotional activities and the personal contacts made by its officers, directors and employees.

For customers whose loan demand exceeds the Bank’s legal lending limit, the Bank may arrange for such loans on a participation basis with correspondent banks. The seasonal swings discussed earlier have, in the past, had some impact on the Bank’s liquidity. The management of investment maturities, sale of loan participations, federal fund borrowings, qualification for funds under the Federal Reserve Bank’s seasonal credit program, and the ability to sell mortgages in the secondary market has allowed the Bank to satisfactorily manage its liquidity.

ITEM 1A - RISK FACTORS

In addition to factors mentioned elsewhere in this Report, the factors contained below, among others, could cause our financial condition and results of operations to be materially and adversely affected. If this were to happen, the value of our common stock could decline, perhaps significantly, and you could lose all or part of your investment.

The Bank is Subject to Lending Risks of Loss and Repayment Associated with Commercial Banking Activities

The Bank’s business strategy is to focus on commercial business loans (which includes agricultural loans), construction loans and commercial and multi-family real estate loans. The principal factors affecting the Bank’s risk of loss in connection with commercial business loans include the borrower's ability to manage its business affairs and cash flows, general economic conditions and, with respect to agricultural loans, weather and climate conditions. Loans secured by commercial real estate are generally larger and involve a greater degree of credit and transaction risk than residential mortgage (one to four family) loans. Because payments on loans secured by commercial and multi-family real estate properties are often dependent on successful operation or management of the underlying properties, repayment of such loans may be dependent on factors other than the prevailing conditions in the real estate market or the economy. Real estate construction financing is generally considered to involve a higher degree of credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value at completion of construction or development compared to the estimated cost (including interest) of construction. If the estimate of value proves to be inaccurate, the Bank may be confronted with a project which, when completed, has a value which is insufficient to assure full repayment of the construction loan.

Although the Bank manages lending risks through its underwriting and credit administration policies, no assurance can be given that such risks will not materialize, in which event, the Company’s financial condition, results of operations, cash flows and business prospects could be materially adversely affected.

The Bank’s Dependence on Real Estate Lending Increases Our Risk of Losses

At December 31, 2006, approximately 70% of the Bank's loans (excluding loans held-for-sale) were secured by real estate. The value of the Bank's real estate collateral has been, and could in the future continue to be, adversely affected by any economic recession and any resulting adverse impact on the real estate market in Northern California such as that experienced during the early 1990's. *See* "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

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The Bank's primary lending focus has historically been commercial (including agricultural), construction and real estate mortgage. At December 31, 2006, real estate mortgage (excluding loans held-for-sale) and construction loans comprised approximately 48% and 22%, respectively, of the total loans in the Bank's portfolio. At December 31, 2006, all of the Bank's real estate mortgage and construction loans and approximately 49% of its commercial loans were secured fully or in part by deeds of trust on underlying real estate. The Company's dependence on real estate increases the risk of loss in both the Bank's loan portfolio and its holdings of other real estate owned if economic conditions in Northern California deteriorate in the future. Deterioration of the real estate market in Northern California would have a material adverse effect on the Company's business, financial condition and results of operations. See "Adverse California Economic Conditions Could Adversely Affect the Bank's Business" below.

Adverse California Economic Conditions Could Adversely Affect the Bank's Business

The Bank's operations and a substantial majority of the Bank's assets and deposits are generated and concentrated primarily in Northern California, particularly the counties of Placer, Sacramento, Solano and Yolo, and are likely to remain so for the foreseeable future. At December 31, 2006, approximately 70% of the Bank's loan portfolio (excluding loans held-for-sale) consisted of real estate-related loans, all of which were secured by collateral located in Northern California. As a result, poor economic conditions in Northern California may cause the Bank to incur losses associated with high default rates and decreased collateral values in its loan portfolio. In the early 1990's, the California economy experienced an economic recession that resulted in increases in the level of delinquencies and losses for many of the state's financial institutions. Economic conditions in California are subject to various uncertainties at this time, including the softening in the California real estate market and housing industry. California's state government has undergone serious fiscal and budget difficulties in the recent past. If economic conditions in California decline or if California were to experience another recession, it is expected that the Bank's level of problem assets would increase accordingly. California real estate is also subject to certain natural disasters, such as earthquakes, floods and mudslides, which are typically not covered by the standard hazard insurance policies maintained by borrowers. Uninsured disasters may make it difficult or impossible for borrowers to repay loans made by the Bank. The occurrence of natural disasters in California could have a material adverse effect on the Company's financial condition, results of operations, cash flows and business prospects.

The Bank is Subject to Interest Rate Risk

The income of the Bank depends to a great extent on "interest rate differentials" and the resulting net interest margins (i.e., the difference between the interest rates earned on the Bank's interest-earning assets such as loans and investment securities, and the interest rates paid on the Bank's interest-bearing liabilities such as deposits and borrowings). These rates are highly sensitive to many factors, which are beyond the Bank's control, including, but not limited to, general economic conditions and the policies of various governmental and regulatory agencies, in particular, the FRB. The Bank is generally adversely affected by declining interest rates. Changes in the relationship between short-term and long-term market interest rates or between different interest rate indices, can also impact our interest rate differential, possibly resulting in a decrease in our interest income relative to interest expense. In addition, changes in monetary policy, including changes in interest rates, influence the origination of loans, the purchase of investments and the generation of deposits and affect the rates received on loans and investment securities and paid on deposits, which could have a material adverse effect on the Company's business, financial condition and results of operations. See "Quantitative and Qualitative Disclosures About Market Risk" below.

Potential Volatility of Deposits May Increase Our Cost of Funds

At December 31, 2006, 11% of the dollar value of the Company's total deposits was represented by time certificates of deposit in excess of \$100,000. These deposits are considered volatile and could be subject to withdrawal. Withdrawal of a material amount of such deposits would adversely impact the Company's liquidity, profitability, business

prospects, results of operations and cash flows.

Our Ability to Pay Dividends is Subject to Legal Restrictions

As a bank holding company, our cash flow typically comes from dividends of the Bank. Various statutory and regulatory provisions restrict the amount of dividends the Bank can pay. The ability of the Company to pay cash dividends in the future also depends on the Company's profitability, growth and capital needs. In addition, California law restricts the ability of the Company to pay dividends. No assurance can be given that the Company will pay any dividends in the future or, if paid, such dividends will not be discontinued. *See* "Business - Restrictions on Dividends and Other Distributions" above.

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Competition Adversely Affects our Profitability

In California generally, and in the Bank's primary market area specifically, major banks dominate the commercial banking industry. By virtue of their larger capital bases, such institutions have substantially greater lending limits than those of the Bank. In obtaining deposits and making loans, the Bank competes with these larger commercial banks and other financial institutions, such as savings and loan associations, credit unions and member institutions of the Farm Credit System, which offer many services that traditionally were offered only by banks. Using the financial holding company structure, insurance companies and securities firms may compete more directly with banks and bank holding companies. In addition, the Bank competes with other institutions such as mutual fund companies, brokerage firms, and even retail stores seeking to penetrate the financial services market. Also, technology and other changes increasingly allow parties to complete financial transactions electronically, and in many cases, without banks. For example, consumers can pay bills and transfer funds over the internet and by telephone without banks. Non-bank financial service providers may have lower overhead costs and are subject to fewer regulatory constraints. If consumers do not use banks to complete their financial transactions, we could potentially lose fee income, deposits and income generated from those deposits. During periods of declining interest rates, competitors with lower costs of capital may solicit the Bank's customers to refinance their loans. Furthermore, during periods of economic slowdown or recession, the Bank's borrowers may face financial difficulties and be more receptive to offers from the Bank's competitors to refinance their loans. No assurance can be given that the Bank will be able to compete with these lenders. See "Business - Competition" above.

Government Regulation and Legislation

The Company and the Bank are subject to extensive state and federal regulation, supervision and legislation, which govern almost all aspects of the operations of the Company and the Bank. The business of the Bank is particularly susceptible to being affected by the enactment of federal and state legislation, which may have the effect of increasing the cost of doing business, modifying permissible activities or enhancing the competitive position of other financial institutions. Such laws are subject to change from time to time and are primarily intended for the protection of consumers, depositors and the deposit insurance funds and not for the protection of shareholders of the Company. The Company cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on the business and prospects of the Company, but it could be material and adverse. See "Bank Regulation and Supervision" above.

Our Controls and Procedures May Fail or be Circumvented

The Company maintains controls and procedures to mitigate against risks such as processing system failures and errors, and customer or employee fraud, and maintains insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Events could occur which are not prevented or detected by the Company's internal controls or are not insured against or are in excess of the Company's insurance limits. Any failure or circumvention of the Company's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

Recent Changes in Deposit Insurance Premiums Could Adversely Affect Our Business

In 2006, the FDIC created a new assessment system designed to more closely tie what banks pay for deposit insurance to the risks they pose and adopted a new base schedule of rates that the FDIC can adjust up or down, depending on the revenue needs of the insurance fund. This new assessment system is expected to result in increased annual assessments on deposits of the Bank. Although an FDIC credit for prior contributions is expected to fully offset the

assessment for 2007, increases in the insurance assessments will increase our costs once the credit is exceeded.

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Negative Public Opinion could Damage Our Reputation and Adversely Affect Our Earnings

Reputational risk, or the risk to our earnings and capital from negative public opinion, is inherent in our business. Negative public opinion can result from the actual or perceived manner in which we conduct our business activities, management of actual or potential conflicts of interest and ethical issues and our protection of confidential client information. Negative public opinion can adversely affect our ability to keep and attract customers and can expose us to litigation and regulatory action. We take steps to minimize reputation risk in the way we conduct our business activities and deal with our clients and communities.

Reliance on Key Employees and Others

The Company's future success depends to a significant extent on the efforts and abilities of its executive officers. The loss of the services of certain of these individuals, or the failure of the Company to attract and retain other qualified personnel, could have a material adverse effect on the Company's business, financial condition and results of operations.

War on Terrorism; Foreign Hostilities

Acts or threats of terrorism and actions taken by the U.S. or other governments as a result of such acts or threats and other international hostilities may result in a downturn in U.S. economic conditions and could adversely affect business and economic conditions in the U.S. generally and in our principal markets. The war in Iraq has also generated various political and economic uncertainties affecting the global and U.S. economies.

Critical Accounting Policies

The Company's financial statements are presented in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The financial information contained within our financial statements is, to a significant extent, financial information that is based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. Along with other factors, we use historical loss factors to determine the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical loss factors that we use. Other estimates that we use are fair value of our securities and expected useful lives of our depreciable assets. We have not entered into derivative contracts for our customers or for ourselves, which relate to interest rate, credit, equity, commodity, energy, or weather-related indices. US GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change. Accounting standards and interpretations currently affecting the Company and its subsidiaries may change at any time, and the Company's financial condition and results of operations may be adversely affected.

Adequacy of Allowance for Loan and Other Real Estate Losses

The Bank's allowance for estimated losses on loans was approximately \$8.4 million, or 1.73% of total loans at December 31, 2006 compared to \$7.9 million or 1.70% of total loans at December 31, 2005 and 243% of total non-performing loans at December 31, 2006 compared to 352% at December 31, 2005. Material future additions to the allowance for estimated losses on loans may be necessary if material adverse changes in economic conditions occur and the performance of the Bank's loan portfolio deteriorates. In addition an allowance for losses on other real estate owned may also be required in order to reflect changes in the markets for real estate in which the Bank's other real estate owned is located and other factors which may result in adjustments which are necessary to ensure that the Bank's foreclosed assets are carried at the lower of cost or fair value, less estimated costs to dispose of the properties.

Moreover, the FDIC and the DFI, as an integral part of their examination process, periodically review the Bank's allowance for estimated losses on loans and the carrying value of its assets. Increases in the provisions for estimated losses on loans and foreclosed assets would adversely affect the Bank's financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Summary of Loan Loss Experience" below.

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Shares Eligible for Future Sale

As of December 31, 2006, the Company had 7,980,952 shares of Common Stock outstanding, all of which are eligible for sale in the public market without restriction. Future sales of substantial amounts of the Company's Common Stock, or the perception that such sales could occur, could have a material adverse effect on the market price of the Common Stock. In addition, options to acquire up to 6% of the unissued authorized shares of Common Stock at exercise prices ranging from \$4.27 to \$27.75 have been issued to directors and employees of the Company, over the past seven (7) years, under the Company's 2000 Stock Option Plan and Outside Directors 2000 Non-statutory Stock Option Plan, and options to acquire up to an additional 10% of the unissued authorized shares of Common Stock are reserved for issuance under such plans. No prediction can be made as to the effect, if any, that future sales of shares, or the availability of shares for future sale, will have on the market price of the Company's Common Stock. *See* "Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" below.

Limited Public Market; Volatility in Stock Price

The Company's common stock is not listed on any exchange, nor is it included on NASDAQ. However, trades may be reported on the OTC Bulletin Board under the symbol "FNRN". The Company is aware that Howe Barnes Hoefler & Arnett, Stone & Youngberg, Wedbush Morgan Securities and Monroe Securities, Inc., all currently make a market in the Company's common stock. Management is aware that there are also private transactions in the Company's common stock. However, the limited trading market for the Company's common stock may make it difficult for shareholders to dispose of their shares. Also, the price of the Company's common stock may be affected by general market price movements as well as developments specifically related to the financial services sector, including interest rate movements, quarterly variations, or changes in financial estimates by securities analysts and a significant reduction in the price of the stock of another participant in the financial services industry, as well as the level of repurchases of Company stock by the Company pursuant to its stock repurchase program.

Technology and Computer Systems

Advances and changes in technology can significantly impact the business and operations of the Company. The Company faces many challenges including the increased demand for providing computer access to Company accounts and the systems to perform banking transactions electronically. The Company's merchant processing services require the use of advanced computer hardware and software technology and rapidly changing customer and regulatory requirements. The Company's ability to compete depends on its ability to continue to adapt its technology on a timely and cost-effective basis to meet these requirements. In addition, the Company's business and operations are susceptible to negative impacts from computer system failures, communication and energy disruption and unethical individuals with the technological ability to cause disruptions or failures of the Company's data processing systems.

Environmental Risks

The Company, in its ordinary course of business, acquires real property securing loans that are in default, and there is a risk that hazardous substances or waste, contaminants or pollutants could exist on such properties. The Company may be required to remove or remediate such substances from the affected properties at its expense, and the cost of such removal or remediation may substantially exceed the value of the affected properties or the loans secured by such properties. Furthermore, the Company may not have adequate remedies against the prior owners or other responsible parties to recover its costs. Finally, the Company may find it difficult or impossible to sell the affected properties either prior to or following any such removal. In addition, the Company may be considered liable for environmental liabilities in connection with its borrowers' properties, if, among other things, it participates in the management of its borrowers' operations. The occurrence of such an event could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

Dilution

As of December 31, 2006, the Company had outstanding options to purchase an aggregate of 517,953 shares of Common Stock at exercise prices ranging from \$4.27 to \$27.75 per share, or a weighted average exercise price per share of \$10.94. To the extent such options are exercised, shareholders of the Company will experience dilution. See "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" below.

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ITEM 1B - UNRESOLVED STAFF COMMENTS

None.

ITEM 2 - PROPERTIES

The Company and the Bank are engaged in the banking business through 19 offices in five counties in Northern California including six offices in Solano County, eight in Yolo County, three in Sacramento County and two in Placer County. In addition, the Company owns two vacant lots, one in northern Solano County and the other in eastern Sacramento County for possible future bank sites. The Company and the Bank believe all of their offices are constructed and equipped to meet prescribed security requirements.

The Bank owns three branch office locations and two administrative facilities and leases 13 facilities. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3 - LEGAL PROCEEDINGS

Neither the Company nor the Bank is a party to any material pending legal proceeding, nor is any of their property the subject of any material pending legal proceeding, except ordinary routine litigation arising in the ordinary course of the Bank's business and incidental to its business, none of which is expected to have a material adverse impact upon the Company's or the Bank's business, financial position or results of operations.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Company's shareholders during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5 - MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is not listed on any exchange, nor is it included on NASDAQ. However, trades may be reported on the OTC Bulletin Board under the symbol "FNRN". The Company is aware that Howe Barnes Hoefler & Arnett, Stone & Youngberg, Wedbush Morgan Securities and Monroe Securities, Inc., all currently make a market in the Company's common stock. Management is aware that there are also private transactions in the Company's common stock and the data set forth below may not reflect all such transactions.

The following table summarizes the range of reported high and low bid quotations of the Company's Common Stock for each quarter during the last two fiscal years and is based on information provided by Stone & Youngberg. The quotations reflect the price that would be received by the seller without retail mark-up, mark-down or commissions and may not have represented actual transactions:

<u>QUARTER/YEAR</u>	<u>HIGH*</u>	<u>LOW*</u>
4th Quarter 2006	\$25.53	\$21.46
3rd Quarter 2006	\$25.46	\$23.58

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2nd Quarter 2006	\$27.36	\$24.62
1st Quarter 2006	\$27.12	\$22.47
4th Quarter 2005	\$22.34	\$20.47
3rd Quarter 2005	\$22.25	\$20.25
2nd Quarter 2005	\$23.04	\$14.24
1st Quarter 2005	\$14.68	\$11.75

* Price adjusted for dividends and splits.

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As of December 31, 2006, there were approximately 1,148 holders of record of the Company's common stock, no par value, which is the only class of equity securities authorized or issued.

In the last two fiscal years the Company has declared the following stock dividends:

<u>Shareholder Record Date</u>	<u>Dividend Percentage</u>	<u>Date Payable</u>
February 28, 2007	6%	March 30, 2007
February 28, 2006	6%	March 31, 2006
February 28, 2005	6%	March 31, 2005

In addition to the above, on April 21, 2005, the Board of Directors of the Company declared a two-for-one stock split. The stock split doubled the outstanding common stock recorded on the books of the Company as of the record date, May 10, 2005.

The Company does not expect to pay a cash dividend in the foreseeable future.

Purchases of Equity Securities by the Issuer or Affiliated Purchasers

On April 20, 2006, the Company approved a stock repurchase program effective April 30, 2006 to replace the Company's previous stock purchase plan that expired on April 30, 2006. The new stock repurchase program, which will remain in effect until April 30, 2008, allows repurchases by the Company in an aggregate of up to 2.5% of the Company's outstanding shares of common stock over each rolling twelve-month period. The Company repurchased 30,078 shares of the Company's outstanding common stock during the fourth quarter of 2006. The following table details stock repurchase activity during this period:

	(a)	(b)	(c)	(d)
Period	Total number of shares purchased	Average price paid per share	Total Number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
October 1 - October 31, 2006	16,599	\$25.24	16,599	138,380
November 1 - November 30, 2006	11,360	\$24.86	11,360	127,020
December 1 - December 31, 2006	2,119	\$23.16	2,119	124,901
Total	30,078	\$24.95	30,078	124,901

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The selected consolidated financial data below have been derived from the Company's audited consolidated financial statements. The selected consolidated financial data set forth below as of December 31, 2003, and 2002 have been derived from the Company's historical financial statements not included in this Report. The financial information for 2006, 2005 and 2004 should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is in Part II (Item 7) of this Report and with the Company's audited consolidated financial statements and the notes thereto, which are included in Part II (Item 8) of this Report.

Consolidated Financial Data as of and for the years ended December 31,

(in thousands, except share and per share amounts)

	2006	2005	2004	2003	2002
Interest Income and Loan Fees	\$ 48,070	\$ 40,902	\$ 31,619	\$ 30,326	\$ 28,941
Interest Expense	(9,426)	(5,729)	(3,426)	(3,109)	(4,237)
Net Interest Income	38,644	35,173	28,193	27,217	24,704
Provision for Loan Losses	(735)	(600)	(207)	(2,153)	(676)
Net Interest Income after Provision for Loan Losses	37,909	34,573	27,986	25,064	24,028
Other Operating Income	5,289	5,720	5,214	7,160	4,972
Other Operating Expense	(29,219)	(26,813)	(22,943)	(22,868)	(20,411)
Income before Taxes	13,979	13,480	10,257	9,356	8,589
Provision for Taxes	(5,169)	(4,792)	(3,550)	(3,245)	(2,871)
Net Income	\$ 8,810	\$ 8,688	\$ 6,707	\$ 6,111	\$ 5,718
Basic Income Per Share	\$ 1.04	\$ 1.02	\$.78	\$.71	\$.65
Diluted Income Per Share	\$ 0.99	\$ 0.98	\$.76	\$.69	\$.64
Total Assets	\$ 685,225	\$ 660,647	\$ 629,503	\$ 559,441	\$ 495,876
Total Investments	\$ 76,273	\$ 48,788	\$ 55,154	\$ 50,235	\$ 69,958
Total Loans, including loans held-for-sale, net	\$ 480,009	\$ 460,501	\$ 433,421	\$ 380,491	\$ 356,018
Total Deposits	\$ 603,682	\$ 581,781	\$ 557,186	\$ 498,849	\$ 442,241
Total Equity	\$ 61,990	\$ 56,802	\$ 51,901	\$ 46,972	\$ 43,442
Weighted Average Shares of Common Stock outstanding used for Basic Income Per Share Computation ¹	8,468,643	8,531,880	8,585,409	8,608,209	8,749,315
Weighted Average Shares of Common Stock outstanding used for Diluted Income Per Share	8,882,925	8,881,596	8,809,916	8,799,158	8,999,552

Computation ¹

Return on Average Total Assets	1.32%	1.35%	1.14%	1.18%	1.25%
Net Income/Average Equity	14.90%	16.17%	13.73%	13.56%	13.71%
Net Income/Average Deposits	1.49%	1.52%	1.28%	1.32%	1.40%
Average Loans/Average Deposits	81.20%	79.44%	75.81%	79.25%	73.99%
Average Equity to Average Total Assets	8.87%	8.37%	8.32%	8.69%	9.11%

1. All years have been restated to give retroactive effect for stock dividends issued and stock splits.

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ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

This report includes forward-looking statements, which include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not rely unduly on forward-looking statements. Actual results might differ significantly from our forecasts and expectations. Please refer to Part I, Item 1A "Risk Factors" for a discussion of some factors that may cause results to differ.

Introduction

This overview of Management's Discussion and Analysis highlights selected information in this annual report and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting estimates, you should carefully read this entire annual report.

Our subsidiary, First Northern Bank of Dixon, is a California state-chartered bank that derives most of its revenues from lending and deposit taking in the Sacramento Valley region of Northern California. Interest rates, business conditions and customer confidence all affect our ability to generate revenues. In addition, the regulatory environment and competition can challenge our ability to generate those revenues.

The Company experienced strong earnings performance in 2006 due to a combination of (1) growth in earning assets, (2) improvement in the mix of earning assets as reflected by an increase in loans as a percentage of average earning assets, and (3) the increase in low cost deposits which helped to support the increase in loans. Financial highlights for 2006 include:

- Net income for 2006 totaled \$8.8 million, a 1.2% increase compared to \$8.7 million for 2005. Net income per common share for 2006 of \$1.04 increased 2.0% compared to \$1.02 for 2005, and net income per common share on a fully diluted basis was \$0.99 for 2006, an increase of 1.0% compared to \$0.98 for 2005.
- Loans (including loans held-for-sale) increased to \$480.0 million at December 31, 2006, a 4.2% increase from \$460.5 million at December 31, 2005. Commercial loans totaled \$97.3 million at December 31, 2006, up 11.7% from \$87.1 million a year earlier; agriculture loans were \$38.6 million, up 17.7% from \$32.8 million at December 31, 2005; real estate construction loans were \$106.8 million, up 3.3% from \$103.4 million at December 31, 2005; and real estate mortgage loans were \$232.0 million, down 0.4% from \$233.0 million a year earlier.
- Average deposits grew to \$589.8 million during 2006, a \$20.0 million or 3.5% increase from 2005.
- The Company reported average total assets of \$666.4 million at December 31, 2006, up 3.7% from \$642.5 million a year earlier.
- The provision for loan losses in 2006 totaled \$735,000, an increase of 22.5% from \$600,000 in 2005. Net charge-offs were \$291,000 in 2006 compared to \$128,000 in net charge-offs in 2005. The increase in the provision for loan losses and increase in net charge-offs can be primarily attributed to increased loan volume combined with charge-offs.
- Net interest income totaled \$38.6 million for 2006, an increase of 9.7% from \$35.2 million in 2005, primarily due to strong loan volumes and increased rates.
-

Other operating income totaled \$5.3 million for the year ended December 31, 2006, a decrease of 7.0% from \$5.7 million for the year ended December 31, 2005. The decrease was due primarily to decreases in gains on sales of loans and gains on other real estate owned.

· Other operating expenses totaled \$29.2 million for 2006, up 9.0% from \$26.8 million in 2005. Contributing to the increase were increased salaries and employee benefits, increased rents and other expenses associated with opening new branches and offices, and advertising expenses.

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In 2007, the Company intends to continue its long-term strategy of maintaining deposit growth to fund growth in loans and other earning assets and intends to identify opportunities for growing other operating income in areas such as Asset Management and Trust and Investment and Brokerage Services, and deposit fee income while remaining conscious of the need to maintain appropriate expense levels. We expect gradual growth in commercial and real estate loan volumes and deposit growth, assuming that inflation remains in check throughout the year. If the current flat or inverted interest rate environment continues, the Company's net interest income and net interest margin may decrease due to an increase in the cost of deposits, unless accompanied by a disproportionate increase in loan volume.

Critical Accounting Policies and Estimates

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, income and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to the allowance for loan losses, other real estate owned, investments and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's most significant estimates are approved by its senior management team. At the end of each financial reporting period, a review of these estimates is presented to the Company's Board of Directors.

The Company believes the following critical accounting policy affects its more significant judgments and estimates used in the preparation of its consolidated financial statements. The Company believes the allowance for loan losses accounting policy is critical because the loan portfolio represents the largest asset type on the consolidated balance sheet. The Company maintains an allowance for loan losses resulting from the inability of borrowers to make required loan payments. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on the Company's periodic evaluation of the factors mentioned below, as well as other pertinent factors. The allowance for loan losses consists of an allocated component and an unallocated component. The components of the allowance for loan losses represent an estimation done pursuant to either Statement of Financial Accounting Standards No. ("SFAS") 5, Accounting for Contingencies, or SFAS 114, Accounting by Creditors for Impairment of a Loan. The allocated component of the allowance for loan losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on regular analyses of all loans where the internal credit rating is at or below a predetermined classification. These analyses involve a high degree of judgment in estimating the amount of loss associated with specific loans, including estimating the amount and timing of future cash flows and collateral values. The historical loan loss element is determined using analysis that examines loss experience.

The allocated component of the allowance for loan losses also includes consideration of concentrations and changes in portfolio mix and volume. The unallocated portion of the allowance reflects the Company's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. Uncertainty surrounding the strength and timing of economic cycles also affects estimates of loss. There are many factors affecting the allowance for loan losses; some are quantitative while others require qualitative judgment. Although the Company believes its process for determining the allowance adequately

considers all of the potential factors that could potentially result in credit losses, the process includes subjective elements and may be susceptible to significant change. To the extent actual outcomes differ from Company estimates, additional provision for credit losses could be required that could adversely affect earnings or financial position in future periods.

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Prospective Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments," which amends the guidance in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 155 provides entities with relief from having to separately determine the fair value of an embedded derivative that would otherwise be required to be bifurcated from its host contract in accordance with SFAS No. 133. SFAS No. 155 allows an entity to make an irrevocable election to measure such a hybrid financial instrument at fair value in its entirety, with changes in fair value recognized in earnings. SFAS No. 155 will be effective for the Company for financial instruments acquired, issued or subject to a re-measurement event in the fiscal year beginning January 1, 2007. The Company does not expect the adoption of SFAS No. 155 will have a material impact on its financial condition, results of operations or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets," which amends the guidance in SFAS No. 140. SFAS No. 156 requires that an entity separately recognize a servicing asset or a servicing liability when it undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be measured initially at fair value, if practicable. SFAS No. 156 also allows an entity to measure its servicing assets and servicing liabilities subsequently using either the amortization method, which existed under SFAS No. 140, or the fair value measurement method. SFAS No. 156 will be effective for the Company in the fiscal year beginning January 1, 2007. The Company does not expect the adoption of SFAS No. 156 will have a material impact on its financial condition, results of operations or cash flows.

In July 2006, the FASB issued Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" and FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes". FIN 48 establishes a "more-likely-than-not" recognition threshold that must be met before a tax benefit can be recognized in the financial statements. For tax positions that meet the "more-likely-than-not" threshold, an enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Interpretation was effective January 1, 2007. The cumulative effect of applying the provisions of the Interpretation would be recognized as an adjustment to the beginning balance of retained earnings. Management is currently evaluating the impact of this Interpretation on the Company's financial position and results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. The Company has not completed its evaluation of the impact of the adoption of this standard.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." Under this standard, the Company may elect to report financial instruments and certain other items at fair value on a contract-by-contract basis with changes in value reported in earnings. This election is irrevocable. SFAS No. 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS No. 133 hedge accounting are not met.

SFAS No. 159 is effective for years beginning after November 15, 2007. Early adoption within 120 days of the beginning of the Company's 2007 fiscal year is permissible, provided the Company has not yet issued interim financial

statements for 2007 and has adopted SFAS No. 157. The Company has not completed its evaluation of the impact of the adoption of this standard.

In September 2006, the Emerging Issues Task Force issued EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with FASB Statement No. 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007. The Company has not completed its evaluation of the impact of the adoption of this standard.

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In September 2006, The Emerging Issues Task Force issued EITF 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." This consensus concludes that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The consensuses are effective for fiscal years beginning after December 15, 2006. The Company has not completed its evaluation of the impact of the adoption of this standard.

STATISTICAL INFORMATION AND DISCUSSION

The following statistical information and discussion should be read in conjunction with the Selected Financial Data included in Part II (Item 6) and the audited consolidated financial statements and accompanying notes included in Part II (Item 8) of this Annual Report on Form 10-K.

The following tables present information regarding the consolidated average assets, liabilities and stockholders' equity, the amounts of interest income from average earning assets and the resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include non-performing loans. Interest income includes proceeds from loans on non-accrual status only to the extent cash payments have been received and applied as interest income. Tax-exempt income is not shown on a tax equivalent basis.

**Distribution of Assets, Liabilities and Stockholders' Equity;
Interest Rates and Interest Differential**

	2006		2005		2004	
	Average Balance	Percent	Average Balance	Percent	Average Balance	Percent
<u>ASSETS</u>						
Cash and Due From Banks	\$ 29,934	4.49%	\$ 31,287	4.87%	\$ 37,542	6.40%
Investment Securities:						
U.S. Government Securities	31,968	4.80%	20,279	3.16%	15,745	2.68%
Obligations of States & Political Subdivisions	23,688	3.56%	27,045	4.21%	32,899	5.60%
Other Securities	11,201	1.68%	3,065	0.48%	3,277	0.56%
Federal Funds Sold	61,904	9.29%	81,948	12.75%	77,169	13.15%
Loans ¹	478,908	71.87%	452,646	70.45%	395,883	67.43%
Other Assets	28,750	4.31%	26,211	4.08%	24,551	4.18%
Total Assets	\$ 666,353	100.00%	\$ 642,481	100.00%	\$ 587,066	100.00%
<u>LIABILITIES & STOCKHOLDERS' EQUITY</u>						
Deposits:						
Demand	\$ 187,766	28.18%	\$ 184,171	28.67%	\$ 158,676	27.03%
Interest-Bearing Transaction Deposits	95,180	14.28%	73,990	11.52%	63,619	10.84%

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Savings & MMDAs	190,036	28.52%	190,562	29.65%	174,539	29.73%
Time Certificates	116,787	17.53%	121,067	18.84%	125,366	21.35%
Borrowed Funds	11,350	1.70%	14,320	2.23%	13,681	2.33%
Other Liabilities	6,113	0.92%	4,627	0.72%	2,332	0.40%
Stockholders' Equity	59,121	8.87%	53,744	8.37%	48,853	8.32%
Total Liabilities & Stockholders' Equity	\$ 666,353	100.00%	\$ 642,481	100.00%	\$ 587,066	100.00%

1. Average Balances for Loans include non-accrual loans and are net of the allowance for loan losses.

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Net Interest Earnings
Average Balances, Yields and Rates
(Dollars in thousands)

Assets	2006			2005			2004		
	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid	Average Balance	Interest Income/Expense	Yields Earned/Rates Paid
Securities:									
U.S. Government	\$ 31,968	\$ 1,299	4.06%	\$ 20,279	\$ 767	3.78%	\$ 15,745	\$ 747	4.74%
Obligations of States And Political Subdivisions ¹	23,688	1,311	5.53%	27,045	1,577	5.83%	32,899	1,892	5.75%
Other Securities	11,201	580	5.18%	3,065	133	4.34%	3,277	135	4.12%
Total Investment Securities	66,857	3,190	4.77%	50,389	2,477	4.92%	51,921	2,774	5.34%
Federal Funds Sold	61,904	2,986	4.82%	81,948	2,587	3.16%	77,169	972	1.26%
Loans ²	478,908	39,082	8.16%	452,646	32,808	7.25%	395,883	25,331	6.40%
Loan Fees	—	2,812	0.59%	—	3,030	0.67%	—	2,542	0.64%
Total Loans, Including Loan Fees	478,908	41,894	8.75%	452,646	35,838	7.92%	395,883	27,873	7.04%
Total Earning Assets	607,669	\$ 48,070	7.91%	584,983	\$ 40,902	6.99%	524,973	\$ 31,619	6.02%
Cash and Due from Banks	29,934			31,287			37,542		
Premises and Equipment	8,188			7,743			7,531		
Interest Receivable and Other Assets	20,562			18,468			17,020		
Total Assets	\$ 666,353			\$ 642,481			\$ 587,066		

1. Interest income and yields on tax-exempt securities are not presented on a tax equivalent basis.
2. Average Balances for Loans include non-accrual loans and are net of the allowance for loan losses, but non-accrued interest thereon is excluded.

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Continuation of
Net Interest Earnings
Average Balances, Yields and Rates
(Dollars in thousands)

Liabilities and Stockholders' Equity	2006			2005			2004		
	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid	Average Balance	Interest Income/ Expense	Yields Earned/ Rates Paid
Interest-Bearing Deposits:									
Interest-Bearing Transaction Deposits	\$ 95,180	\$ 1,568	1.65%	\$ 73,990	\$ 512	0.69%	\$ 63,619	\$ 89	0.14%
Savings & MMDAs	190,036	3,813	2.01%	190,562	2,279	1.20%	174,539	893	0.51%
Time Certificates	116,787	3,682	3.15%	121,067	2,443	2.02%	125,366	2,003	1.60%
Total Interest-Bearing Deposits	402,003	9,063	2.25%	385,619	5,234	1.36%	363,524	2,985	0.82%
Borrowed Funds	11,350	363	3.20%	14,320	495	3.46%	13,681	441	3.22%
Total Interest-Bearing Deposits and Funds	413,353	9,426	2.28%	399,939	5,729	1.43%	377,205	3,426	0.91%
Demand Deposits	187,766	—	—	184,171	—	—	158,676	—	—
Total Deposits and Borrowed Funds	601,119	\$ 9,426	1.57%	584,110	\$ 5,729	0.98%	535,881	\$ 3,426	0.64%
Accrued Interest and Other Liabilities	6,113			4,627			2,332		
Stockholders' Equity	59,121			53,744			48,853		
Total Liabilities and Stockholders' Equity	\$ 666,353			\$ 642,481			\$ 587,066		
		\$ 38,644	6.36%		\$ 35,173	6.01%		\$ 28,193	5.37%

Net Interest Income
and Net Interest
Margin ¹

Net Interest Spread ²	5.63%	5.56%	5.11%
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1. Net interest margin is computed by dividing net interest income by total average interest-earning assets.
2. Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

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Analysis of Changes
in Interest Income and Interest Expense
(Dollars in thousands)

Following is an analysis of changes in interest income and expense (dollars in thousands) for 2006 over 2005 and 2005 over 2004. Changes not solely due to interest rate or volume have been allocated proportionately to interest rate and volume.

	2006 Over 2005			2005 Over 2004		
	Volume	Interest Rate	Change	Volume	Interest Rate	Change
Increase (Decrease) in Interest Income:						
Loans & Banker's Acceptance	\$ 1,983	\$ 4,291	\$ 6,274	\$ 3,882	\$ 3,595	\$ 7,477
Investment Securities	787	(74)	713	(81)	(216)	(297)
Federal Funds Sold	(347)	746	399	63	1,552	1,615
Loan Fees	(218)	—	(218)	488	—	488
	\$ 2,205	\$ 4,963	\$ 7,168	\$ 4,352	\$ 4,931	\$ 9,283
Increase (Decrease) in Interest Expense:						
Deposits:						
Interest-Bearing						
Transaction Deposits	\$ 180	\$ 876	\$ 1,056	\$ 17	\$ 406	\$ 423
Savings & MMDAs	(6)	1,540	1,534	88	1,298	1,386
Time Certificates	(83)	1,322	1,239	(66)	506	440
Borrowed Funds	(97)	(35)	(132)	21	33	54
	\$ (6)	\$ 3,703	\$ 3,697	\$ 60	\$ 2,243	\$ 2,303
Increase (Decrease) in Net Interest Income	\$ 2,211	\$ 1,260	\$ 3,471	\$ 4,292	\$ 2,688	\$ 6,980

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The mix of investment securities held by the Company at December 31, for the previous three fiscal years is as follows (dollars in thousands):

	2006	2005	2004
Investment securities available for sale:			
U.S. Treasury Securities	\$ 253	\$ 250	\$ 256
Securities of U.S. Government Agencies and Corporations	31,703	21,556	21,063
Obligations of State & Political Subdivisions	30,193	23,047	30,747
Mortgage Backed Securities	12,031	1,803	1,260
Other Securities	2,093	2,132	1,828
Total Investments	\$ 76,273	\$ 48,788	\$ 55,154

Maturities of Investment Securities

The following table is a summary of the relative maturities (dollars in thousands) and yields of the Company's investment securities as of December 31, 2006. The yields on tax-exempt securities are shown on a tax equivalent basis.

Period to Maturity

<u>Security</u>	Within One Year		After One But Within Five Years		After Five But Within Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield
U.S. Treasury Securities	\$ —	—	\$ 253	5.00%	\$ —	—
Securities of U.S. Government Agencies and Corporations	6,907	3.16%	20,708	4.38%	4,088	5.26%
Obligations of State & Political Subdivisions	5,356	7.12%	8,534	7.37%	5,712	6.72%
Mortgage Backed Securities	35	7.10%	11,996	5.14%	—	—
TOTAL	\$ 12,298	4.90%	\$ 41,491	5.22%	\$ 9,800	6.11%
<u>Security</u>	After Ten Years		Other		Total	
	Amount	Yield	Amount	Yield	Amount	Yield

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U.S. Treasury Securities	\$	—	—\$	—	—\$	253	5.00%
Securities of U.S. Government Agencies and Corporations		—	—	—	—	31,703	4.23%
Obligations of State & Political Subdivisions		10,591	6.27%	—	—	30,193	6.82%
Mortgage Backed Securities		—	—	—	—	12,031	5.15%
Other Securities		—	—	2,093	5.13%	2,093	5.13%
TOTAL	\$	10,591	6.27%	\$ 2,093	5.13%	\$ 76,273	5.43%

Table of Contents**LOAN PORTFOLIO****Composition of Loans**

The mix of loans, net of deferred origination fees and allowance for loan losses and excluding loans held-for-sale, at December 31, for the previous five fiscal years is as follows (dollars in thousands):

	2006		December 31, 2005		2004	
	Balance	Percent	Balance	Percent	Balance	Percent
Commercial	\$ 97,268	20.5%	87,091	19.1%	\$ 89,721	20.9%
Agriculture	38,607	8.1%	32,808	7.2%	32,910	7.7%
Real Estate Mortgage	227,552	47.9%	228,524	50.1%	216,846	50.4%
Real Estate						
Construction	106,752	22.4%	103,422	22.7%	85,584	19.9%
Installment	5,370	1.1%	4,216	0.9%	4,641	1.1%
TOTAL	\$ 475,549	100.0%	\$ 456,061	100.0%	\$ 429,702	100.0%

	2003		2002	
	Balance	Percent	Balance	Percent
Commercial	\$ 88,949	24.1%	\$ 76,887	24.6%
Agriculture	32,766	8.9%	31,926	10.2%
Real Estate Mortgage	174,867	47.2%	144,171	46.0%
Real Estate Construction	68,370	18.5%	54,094	17.3%
Installment	4,867	1.3%	5,967	1.9%
TOTAL	\$ 369,819	100.0%	\$ 313,045	100.0%

Commercial loans are primarily for financing the needs of a diverse group of businesses located in the Bank's market area. The Bank also makes loans to individuals for investment purposes. Most of these loans are relatively short-term (an overall average life of approximately two years) and secured by various types of collateral. Real estate construction loans are generally for financing the construction of single-family residential homes for well-qualified individuals and builders. These loans are secured by real estate and have short maturities.

As shown in the comparative figures for loan mix during 2006 and 2005, total loans increased as a result of increases in commercial loans, agriculture loans, real estate construction loans and installment loans which were partially offset by a decrease in real estate mortgage loans.

Table of Contents**Maturities and Sensitivities of Loans to Changes in Interest Rates**

Loan maturities of the loan portfolio at December 31, 2006 are as follows (dollars in thousands) (excludes loans held-for-sale):

Maturing	Fixed Rate	Variable Rate	Total
Within one year	\$ 52,221	\$ 174,338	\$ 226,559
After one year through five years	44,208	110,925	155,133
After five years	18,169	75,688	93,857
Total	\$ 114,598	\$ 360,951	\$ 475,549

Non-accrual, Past Due and Restructured Loans

It is the Bank's policy to recognize interest income on an accrual basis. Accrual of interest is suspended when a loan has been in default as to principal or interest for 90 days, unless well secured by collateral believed by management to have a fair market value that at least equals the book value of the loan plus accrued interest receivable and in the process of collection. Real estate acquired through foreclosure is written down to its estimated fair market value at the time of acquisition and is carried as a non-earning asset until sold. Any write-down at the time of acquisition is charged against the allowance for loan losses; subsequent write-downs or gains or losses upon disposition are credited or charged to non-interest income/expense. The Bank has made no foreign loans.

The following table shows the aggregate amounts of assets (dollars in thousands) in each category at December 31, for the years indicated:

	2006	2005	2004	2003	2002
Non-accrual Loans	\$ 3,399	\$ 2,073	\$ 4,907	\$ 3,877	\$ 552
90 Days Past Due But Still Accruing	37	178	55	4	8
Total Non-performing Loans	3,436	2,251	4,962	3,881	560
Other Real Estate Owned	375	268	—	—	—
Total Non-performing Assets	\$ 3,811	\$ 2,519	\$ 4,962	\$ 3,881	\$ 560

If interest on non-accrual loans had been accrued, such interest income would have approximated \$280,000, \$101,000, and \$280,000 during the years ended December 31, 2006, 2005 and 2004, respectively. Income actually recognized for these loans approximated \$113,000, \$100,000 and \$64,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

There was a \$1,292,000 increase in non-performing assets for 2006 over 2005. At December 31, 2006, non-performing assets included five non-accrual commercial loans totaling \$1,469,000, two non-accrual agricultural loans totaling \$620,000, one non-accrual commercial real estate loan totaling \$90,000 and one non-accrual residential mortgage loan totaling \$1,220,000. Additional non-performing assets included two loans past due more than 90 days totaling \$37,000. Other Real Estate Owned ("OREO") properties totaled \$375,000 at December 31, 2006. The Bank's management believes that nearly \$3,277,000 of the \$3,399,000 in non-accrual loans at December 31, 2006, are adequately collateralized or guaranteed by a governmental entity, and the remaining \$122,000 may have some potential loss which management believes is sufficiently covered by the Bank's existing loan loss reserve (Allowance for Loan Losses).

Table of Contents**Potential Problem Loans**

In addition to the non-performing assets described above, the Bank's Branch Managers each month submit to the Loan Committee of the Board of Directors a report detailing the status of those loans that are past due over sixty days and each quarter a report detailing the status of those loans that are classified as such. Also included in the report are those loans that are not necessarily past due, but the branch manager is aware of problems with these loans which may result in a loss.

The monthly Allowance for Loan Loss Analysis Report is prepared based upon the Problem Loan Report, internal loan grading, regulatory classifications and loan review classification and is reviewed by the Management Loan Committee of the Bank. The Management Loan Committee reviewed the Allowance for Loan Loss Analysis Report, dated December 31, 2006, on January 9, 2007. This report included all non-performing loans reported in the table on the previous page and all other potential problem loans. Excluding the non-performing loans cited previously, loans totaling \$10,744,000 were classified as potential problem loans. The Bank's management believes that of these loans, loans totaling \$10,434,000 are adequately collateralized or guaranteed, the remaining loans totaling \$310,000 may have some loss potential which management believes is sufficiently covered by the Bank's existing loan loss reserve (Allowance for Loan Losses). The ratio of the Allowance for Loan Losses to total loans at December 31, 2006 was 1.73%.

SUMMARY OF LOAN LOSS EXPERIENCE

The Allowance for Loan Losses is maintained at a level believed by management to be adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The Bank makes credit reviews of the loan portfolio and considers current economic conditions, loan loss experience, and other factors in determining the adequacy of the allowance for loan losses. The allowance for loan losses is based on estimates and actual losses may vary from current estimates.

Analysis of the Allowance for Loan Losses

(Dollars in thousands)

	2006	2005	2004	2003	2002
Balance at Beginning of Year	\$ 7,917	\$ 7,445	\$ 7,006	\$ 6,630	\$ 6,116
Provision for (Recovery of) Loan Losses	735	600	207	2,153	676
Loans Charged-Off:					
Commercial	(572)	(670)	(122)	(143)	(51)
Agriculture	(57)	—	(214)	(1,662)	(191)
Installment Loans to Individuals	(431)	(185)	(46)	(104)	(87)
Total Charged-Off	(1,060)	(855)	(382)	(1,909)	(329)
Recoveries:					
Commercial	561	64	199	101	92
Agriculture	—	663	399	11	33
Real Estate Mortgage	—	—	—	—	35
Installment Loans to Individuals	208	—	16	20	7
Total Recoveries	769	727	614	132	167

Net (Charge-Offs) Recoveries	(291)	(128)	232	(1,777)	(162)
Balance at End of Year	\$ 8,361	\$ 7,917	\$ 7,445	\$ 7,006	\$ 6,630
Ratio of Net (Charge-Offs) Recoveries During the Year to Average Loans Outstanding During the Year	(0.06%)	(0.03%)	0.06%	(0.48%)	(0.05%)

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Table of Contents**Allocation of the Allowance for Loan Losses**

The Allowance for Loan Losses has been established as a general reserve available to absorb probable inherent losses throughout the Loan Portfolio. The following table is an allocation of the Allowance for Loan Losses balance on the dates indicated (dollars in thousands):

Loan Type:	December 31, 2006		December 31, 2005		December 31, 2004	
	Allocation of Allowance for Loan Losses Balance	Loans as a % of Total Loans	Allocation of Allowance for Loan Losses Balance	Loans as a % of Total Loans	Allocation of Allowance for Loan Losses Balance	Loans as a % of Total Loans
Commercial	\$ 2,037	20.5%	\$ 1,779	19.1%	\$ 1,727	20.9%
Agriculture	1,133	8.1%	1,518	7.2%	1,484	7.7%
Real Estate Mortgage	3,016	47.9%	3,003	50.1%	2,767	50.4%
Real Estate Construction	1,535	22.4%	1,001	22.7%	668	19.9%
Installment	640	1.1%	616	0.9%	801	1.1%
Total	\$ 8,361	100.0%	\$ 7,917	100.0%	\$ 7,445	100.0%

Loan Type:	December 31, 2003		December 31, 2002	
	Allocation of Allowance for Loan Losses Balance	Loans as a % of Total Loans	Allocation of Allowance for Loan Losses Balance	Loans as a % of Total Loans
Commercial	\$ 1,881	24.1%	\$ 2,377	24.6%
Agriculture	1,746	8.9%	974	10.2%
Real Estate Mortgage	2,181	47.2%	279	46.0%
Real Estate Construction	621	18.5%	2,472	17.3%
Installment	577	1.3%	528	1.9%

Total	\$	7,006	100.0%	\$	6,630	100.0%
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The Bank believes that any breakdown or allocation of the Reserve into loan categories lends an appearance of exactness, which does not exist, because the Reserve is available for all loans. The Reserve breakdown shown above is computed taking actual experience into consideration but should not be interpreted as an indication of the specific amount and allocation of actual charge-offs that may ultimately occur.

Table of Contents**Deposits**

The following table sets forth the average amount and the average rate paid on each of the listed deposit categories (dollars in thousands) during the periods specified:

Deposit Type:	2006		2005		2004	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
Non-interest-Bearing Demand	\$ 187,766	—	\$ 184,171	—	\$ 158,676	—
Interest-Bearing Demand (NOW)	\$ 95,180	1.65%	\$ 73,990	0.69%	\$ 63,619	0.14%
Savings and MMDAs	\$ 190,036	2.01%	\$ 190,562	1.20%	\$ 174,539	0.51%
Time	\$ 116,787	3.15%	\$ 121,067	2.02%	\$ 125,366	1.60%

The following table sets forth by time remaining to maturity the Bank's time deposits in the amount of \$100,000 or more (dollars in thousands) as of December 31, 2006:

Three months or less	\$ 28,729
Over three months through twelve months	32,355
Over twelve months	5,215
Total	\$ 66,299

Short-Term Borrowings

Short-term borrowings at December 31, 2006 and 2005 consisted of secured borrowings from the U.S. Treasury in the amounts of \$858,000 and \$1,476,000, respectively. The funds are placed at the discretion of the U.S. Treasury and are callable on demand by the U.S. Treasury.

Additional short-term borrowings available to the Company consist of a line of credit and advances from the Federal Home Loan Bank ("FHLB") secured under terms of a blanket collateral agreement by a pledge of FHLB stock and certain other qualifying collateral such as commercial and mortgage loans. At December 31, 2006, the Company had a current collateral borrowing capacity from the FHLB of \$93,832,000. The Company also has unsecured formal lines of credit totaling \$25,700,000 with correspondent banks and borrowing capacity of \$2,000,000 with the Federal Reserve Bank (loans and discounts), which is fully collateralized, with a pledge of U.S. Agency Notes.

Long-Term Borrowings

Long-term borrowings consisted of Federal Home Loan Bank advances, totaling \$10,124,000 and \$13,493,000, respectively, at December 31, 2006 and 2005. Such advances ranged in maturity from 1.4 years to 2.3 years at a weighted average interest rate of 2.91% at December 31, 2006. Maturity ranged from 0.3 years to 3.3 years at a weighted average interest rate of 3.48% at December 31, 2005. Average outstanding balances were \$10,776,000 and \$13,628,000, respectively, during 2006 and 2005. The weighted average interest rate paid was 3.15% in 2006 and 3.48% in 2005.

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Results of Operations

Net Income

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net income for the year ended December 31, 2006, was \$8,810,000, representing an increase of \$122,000, or 1.4% over net income of \$8,688,000 for the year ended December 31, 2005. The increase in net income is principally attributable to a \$3,471,000 increase in net interest income, which was partially offset by a decrease of \$431,000 in other operating income, a \$1,539,000 increase in salaries and employee benefits, an increase of \$135,000 in the provision for loan losses, a \$437,000 increase in occupancy and equipment, an increase of \$175,000 in data processing, a \$158,000 increase in advertising, and a \$377,000 increase in the provision for income taxes.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net income for the year ended December 31, 2005, was \$8,688,000, representing an increase of \$1,981,000, or 30% over net income of \$6,707,000 for the year ended December 31, 2004. The increase in net income is principally attributable to a \$6,980,000 increase in net interest income and an increase of \$506,000 in other operating income, which was partially offset by a \$2,371,000 increase in salaries and employee benefits, an increase of \$393,000 in the provision for loan losses, a \$194,000 increase in occupancy and equipment, a \$320,000 increase in advertising, and a \$1,242,000 increase in the provision for income taxes.

Net Interest Income

Net interest income is the excess of interest and fees earned on the Bank's loans, investment securities, federal funds sold and banker's acceptances over the interest expense paid on deposits, mortgage notes and other borrowed funds. It is primarily affected by the yields on the Bank's interest-earning assets and loan fees and interest-bearing liabilities outstanding during the period. The \$3,471,000 increase in the Bank's net interest income in 2006 from 2005 was due to the effects of a higher level of core deposits and strong commercial and real estate loan volumes, combined with higher funding costs. The \$6,980,000 increase in 2005 from 2004 was due to the effects of a higher level of core deposits and strong commercial and real estate loan volumes, combined with higher funding costs. The "Analysis of Changes in Interest Income and Interest Expense" set forth on page 28 of this Annual Report on Form 10-K identifies the effects of interest rates and loan/deposit volume. Another factor that affected the net interest income was the average earning asset to average total asset ratio. This ratio was 91.2% in 2006, 91.1% in 2005 and 89.4% in 2004.

Interest income on loans (including loan fees) was \$41,894,000 for 2006, representing an increase of \$6,056,000, or 16.9% from \$35,838,000 for 2005. This compared to an increase in 2005 of \$7,965,000 or 28.58% greater than loan interest income earned in 2004. The increased interest income on loans in 2006 over 2005 was the result of a 5.8% increase in loan volume, combined with a 91 basis point increase in loan interest rates, which was partially offset by a decrease of approximately \$218,000 in loan fees. Loan fee comparisons were impacted by a net decrease in deferred loan fees and costs of \$355,000 in 2006, a net decrease of \$373,000 in 2005, and a net increase of \$326,000 in 2004.

Average outstanding federal funds sold fluctuated during this period, ranging from \$61,904,000, in 2006 to \$81,948,000 in 2005 and \$77,169,000 in 2004. At December 31, 2006 federal funds sold were \$62,470,000. Federal funds are used primarily as a short-term investment to provide liquidity for funding of loan commitments or to accommodate seasonal deposit fluctuations. Federal funds sold yields were 4.82%, 3.16% and 1.26% for 2006, 2005 and 2004, respectively.

The average total level of investment securities increased \$16,468,000 in 2006 to \$66,857,000 from \$50,389,000 in 2005 and decreased \$1,532,000 in 2005 to \$50,389,000 from \$51,921,000 in 2004. The level of securities interest income attributable to investment securities increased to \$3,190,000 in 2006 from \$2,477,000 in 2005 and \$2,774,000 in 2004, due to the effects of interest rates and volume. The Bank's strategy for this period has emphasized the use of the investment portfolio to maintain the Bank's increasing loan demand. The Bank continues to reinvest maturing securities to provide future liquidity while attempting to reinvest the cash flows in short duration securities that provide higher cash flow for reinvestment in a higher interest rate instrument. Investment securities yields were 4.77%, 4.92% and 5.34% for 2006, 2005 and 2004, respectively.

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Total interest expense increased to \$9,426,000 in 2006 from \$5,729,000 in 2005, and increased to \$5,729,000 in 2005 from \$3,426,000 in 2004, representing a 64.53% increase in 2006 over 2005 and a 67.22% increase in 2005 over 2004. The increase in total interest expense from 2006 to 2005 was due to increases in volume combined with increases in interest rates paid on deposits. The increase in total interest expense from 2005 to 2004 was due to increases in volume combined with increases in interest rates paid on deposits.

The mix of deposits for the previous three years is as follows (dollars in thousands):

	2006		2005		2004	
	Average Balance	Percent	Average Balance	Percent	Average Balance	Percent
Non-interest-Bearing Demand	\$ 187,766	31.9%	\$ 184,171	32.3%	\$ 158,676	30.4%
Interest-Bearing Demand (NOW)	95,180	16.1%	73,990	13.0%	63,619	12.2%
Savings and MMDAs	190,036	32.2%	190,562	33.4%	174,539	33.4%
Time	116,787	19.8%	121,067	21.3%	125,366	24.0%
Total	\$ 589,769	100.0%	\$ 569,790	100.0%	\$ 522,200	100.0%

The three years ended December 31, 2006 have been characterized by fluctuating interest rates. Loan rates and deposit rates both increased in 2006, 2005 and 2004. The net spread between the rate for total earning assets and the rate for total deposits and borrowed funds increased 7 basis points in the period from 2006 to 2005 and increased 45 basis points in the period from 2005 to 2004.

The Bank's net interest margin (net interest income divided by average earning assets) was 6.36% in 2006, 6.01% in 2005, and 5.37% in 2004. The net interest margin benefited in 2006 from rising interest rates combined with increased loan volume and was partially offset by higher cost of funds, the continued flattening of the yield curve, a slowdown in mortgage originations and maturities and calls of higher yielding securities. Going forward into the first half of 2007, it is Bank managements belief that net interest income and net interest margin will be flat because of anticipated stabilization of the Federal Funds Rate.

Provision for Loan Losses

The provision for loan losses is established by charges to earnings based on management's overall evaluation of the collectibility of the loan portfolio. Based on this evaluation, the provision for loan losses increased to \$735,000 in 2006 from \$600,000 in 2005, primarily as a result of loan growth and loan quality in the Bank's loan portfolio. The amount of loans charged-off increased in 2006 to \$1,060,000 from \$855,000 in 2005, and recoveries increased to \$769,000 in 2006 from \$727,000 in 2005. The increase in charge-offs was due, for the most part, to an increase in charge-offs of installment loans to individuals. The ratio of the Allowance for Loan Losses to total loans at December 31, 2006 was 1.73% compared to 1.70% at December 31, 2005. The ratio of the Allowance for Loan Losses to total non-accrual loans and loans past due 90 days or more at December 31, 2006 was 243% compared to 352% at

December 31, 2005.

The provision for loan losses is established by charges to earnings based on management's overall evaluation of the collectibility of the loan portfolio. Based on this evaluation, the provision for loan losses increased to \$600,000 in 2005 from \$207,000 in 2004, primarily as a result of loan growth and loan quality in the Bank's loan portfolio. The amount of loans charged-off increased in 2005 to \$855,000 from \$382,000 in 2004, and recoveries increased to \$727,000 in 2005 from \$614,000 in 2004. The increase in charge-offs was due, for the most part, to a charge-off of an unsecured commercial loan. The ratio of the Allowance for Loan Losses to total loans at December 31, 2005 was 1.70% compared to 1.70% at December 31, 2004. The ratio of the Allowance for Loan Losses to total non-accrual loans and loans past due 90 days or more at December 31, 2005 was 352% compared to 150% at December 31, 2004.

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Table of Contents**Other Operating Income and Expenses**

Other operating income consisted primarily of service charges on deposit accounts and other income, which was partially offset by a decrease in net realized gains on loans held for sale and a decrease in gains on other real estate owned. Service charges on deposit accounts increased \$420,000 in 2006 over 2005 and \$197,000 in 2005 over 2004. The increase in 2006 was due, for the most part, to increased service charges on regular and business checking accounts. Net realized gains on loans held-for-sale decreased \$718,000 in 2006 over 2005 and increased \$21,000 in 2005 over 2004. The decrease in 2006 was due, for the most part, to a decrease in sold loans. Gains on other real estate owned decreased \$317,000 in 2006 over 2005 and increased \$291,000 in 2005 over 2004. The decrease in 2006 was due to the sale of a previously foreclosed commercial property. Other income increased \$199,000 in 2006 over 2005 and decreased \$15,000 in 2005 over 2004.

The Bank realized net gains of \$-0- on sale of investment securities in 2006, \$15,000 in 2005 and \$3,000 in 2004.

Other operating expenses consisted primarily of salaries and employee benefits, occupancy and equipment expense, data processing, advertising, and other expenses. Other operating expenses increased to \$29,219,000 in 2006 from \$26,813,000 in 2005, and increased to \$26,813,000 in 2005 from \$22,943,000 in 2004, representing an increase of \$2,406,000, or 9.0% in 2006 over 2005, and an increase of \$3,870,000, or 16.9% in 2005 over 2004.

Following is an analysis of the increase or decrease in the components of other operating expenses (dollars in thousands) during the periods specified:

	2006 over 2005		2005 over 2004	
	Amount	Percent	Amount	Percent
Salaries and Employee Benefits	\$ 1,539	9.7%	\$ 2,371	17.5%
Occupancy and Equipment	437	13.5%	194	6.4%
Data Processing	175	14.5%	130	12.0%
Stationery and Supplies	43	8.9%	(5)	(1.0%)
Advertising	158	21.5%	320	76.9%
Directors Fees	34	26.6%	1	0.8%
Other Expense	20	0.4%	859	20.2%
Total	\$ 2,406	9.0%	\$ 3,870	16.9%

In 2006, salaries and employee benefits increased \$1,539,000 to \$17,455,000 from \$15,916,000 for 2005. This increase was due, for the most part, to an increase in regular salaries, incentive compensation, profit sharing payments and group insurance. Increases in occupancy and equipment were associated with increased rents and equipment associated with opening new branches and offices. Increases in the data processing area were attributed to continued emphasis on Internet-related products and security services and network improvements. Increases in stationary and supplies were attributed to an increase in the usage of office supplies. Increases in advertising were due to increased costs related to promoting new deposit products. Increases in director fees were due to increased fees.

In 2005, salaries and employee benefits increased \$2,371,000 to \$15,916,000 from \$13,545,000 for 2004. This increase was due, for the most part, to an increase in regular salaries, incentive compensation and profit sharing payments. Increases in occupancy and equipment were associated with increased rents and equipment associated with opening new branches and offices. Increases in the data processing area were attributed to continued emphasis on Internet-related products and security services and network improvements. Increases in advertising were due to increased costs related to promoting new deposit products. Other expenses increased, for the most part, due to increased accounting, audit and consulting fees associated with Sarbanes-Oxley Act compliance.

Income Taxes

The provision for income taxes is primarily affected by the tax rate, the level of earnings before taxes and the amount of lower taxes provided by non-taxable earnings. In 2006, taxes increased \$377,000 to \$5,169,000 from \$4,792,000 for 2005. In 2005, taxes increased \$1,242,000 to \$4,792,000 from \$3,550,000 for 2004. The Bank's effective tax rate was 37%, 36%, and 35%, for the years ended December 31, 2006, 2005 and 2004, respectively. Non-taxable municipal bond income was \$636,000, \$562,000, and \$610,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

Table of Contents**Liquidity, Contractual Obligations, Commitments, Off-Balance Sheet Arrangements and Capital Resources**

Liquidity is defined as the ability to generate cash at a reasonable cost to fulfill lending commitments and support asset growth, while satisfying the withdrawal demands of customers and any borrowing requirements. The Bank's principal sources of liquidity are core deposits and loan and investment payments and prepayments. Providing a secondary source of liquidity is the available-for-sale investment portfolio. As a final source of liquidity, the Bank can exercise existing credit arrangements.

The Company's primary source of liquidity on a stand-alone basis is dividends from the Bank. As discussed in Part I (Item 1) of this Annual Report on Form 10-K, dividends from the Bank are subject to regulatory restrictions.

As discussed in Part I (Item 1) of this Annual Report on Form 10-K, the Bank experiences seasonal swings in deposits, which impact liquidity. Management has adjusted to these seasonal swings by scheduling investment maturities and developing seasonal credit arrangements with the Federal Reserve Bank and Federal Funds lines of credit with correspondent banks. In addition, the ability of the Bank's real estate department to originate and sell loans into the secondary market has provided another tool for the management of liquidity. As of December 31, 2006, the Company has not created any special purpose entities to securitize assets or to obtain off-balance sheet funding.

The liquidity position of the Bank is managed daily, thus enabling the Bank to adapt its position according to market fluctuations. Liquidity is measured by various ratios, the most common of which is the ratio of net loans (including loans held-for-sale) to deposits. This ratio was 79.6% on December 31, 2006, 79.2% on December 31, 2005, and 77.8% on December 31, 2004. At December 31, 2006 and 2005, the Bank's ratio of core deposits to total assets was 78.5% and 78.1%, respectively. Core deposits are important in maintaining a strong liquidity position as they represent a stable and relatively low cost source of funds. The Bank's liquidity position increased slightly in 2006; management believes that it remains adequate. This is best illustrated by the change in the Bank's net non-core and net short-term non-core funding dependence ratio, which explain the degree of reliance on non-core liabilities to fund long-term assets. At December 31, 2006, the Bank's net core funding dependence ratio, the difference between non-core funds, time deposits \$100,000 or more and brokered time deposits under \$100,000, and short-term investments to long-term assets, was 0.53%, compared to -3.54% in 2005. The Bank's net short-term non-core funding dependence ratio, non-core funds maturing within one year, including borrowed funds, less short-term investments to long-term assets equaled -2.29% at the end of 2006, compared to -6.32% at year-end 2005. These ratios indicated at December 31, 2006, the Bank had minimal reliance on non-core deposits and borrowings to fund the Bank's long-term assets, namely loans and investments. The Bank believes that by maintaining adequate volumes of short-term investments and implementing competitive pricing strategies on deposits, it can ensure adequate liquidity to support future growth. The Bank also believes that its liquidity position remains strong to meet both present and future financial obligations and commitments, events or uncertainties that have resulted or are reasonably likely to result in material changes with respect to the Bank's liquidity.

The Company has various financial obligations, including contractual obligations and commitments that may require future cash payments. The following table presents, as of December 31, 2006, the Company's significant fixed and determinable contractual obligations to third parties by payment date:

Contractual Obligations	Total	Payments due by period			More than 5 years
		Less than 1 year	1-3 years	3-5 years	
Deposits without a stated maturity (a)	\$ 490,246	490,246	—	—	—

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Certificates of Deposit (a)	113,436	104,675	5,534	3,227	—
Short-Term Borrowings (a)	858	858	—	—	—
Long-Term Borrowings (b)	10,654	511	10,143	—	—
Operating Leases	6,545	1,212	2,333	1,265	1,735
Purchase Obligations	1,454	1,454	—	—	—
Total	\$ 623,193	598,956	18,010	4,492	1,735

(a) Excludes interest
(b) Includes interest on fixed rate obligations.

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The Company's operating lease obligations represent short-term and long-term lease and rental payments for facilities, certain software and data processing and other equipment. Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology, capital expenditures, and the outsourcing of certain operational activities.

The Company's long-term borrowing consists of FHLB fixed-rate obligations. FHLB advances are collateralized by qualifying residential real estate loans.

The Company's borrowed funds consist of secured borrowings from the U.S. Treasury. These borrowings are collateralized by qualifying securities. The funds are placed at the discretion of the U.S. Treasury and are callable on demand by the U.S. Treasury.

The following table details the amounts and expected maturities of commitments as of December 31, 2006:

Commitments	Total	Maturities by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Commitments to extend credit					
Commercial	\$ 67,969	62,181	2,719	1,784	1,285
Agriculture	25,496	23,076	19	2,401	—
Real Estate Mortgage	58,220	3,983	5,608	24,018	24,611
Real Estate Construction	43,644	33,454	7,956	—	2,234
Installment	2,871	1,503	1,338	30	—
Standby Letters of Credit	12,222	12,220	2	—	—
Total	\$ 210,422	136,417	17,642	28,233	28,130

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans or through standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. These loans have been sold to third parties without recourse, subject to customary default, representations and warranties, recourse for breaches of the terms of the sales contracts and payment default recourse.

Financial instruments, whose contract amounts represent credit risk at December 31 of the indicated years, are as follows:

	2006	2005
Undisbursed loan commitments	\$ 198,200	\$ 203,101

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Standby letters of credit	12,222	14,077
Commitments to sell loans	700	—
	\$ 211,122	\$ 217,178

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The Bank expects its liquidity position to remain strong in 2007 as the Bank expects to continue to grow into existing and new markets. The stock market has rebounded this past year and, while the Bank did not experience a significant outflow of deposits, the potential of additional outflows still exists as the stock market continues to improve. Regardless of the outcome, the Bank believes that it has the means to provide adequate liquidity for funding normal operations in 2007.

The Bank believes a strong capital position is essential to the Bank's continued growth and profitability. A solid capital base provides depositors and shareholders with a margin of safety, while allowing the Bank to take advantage of profitable opportunities, support future growth and provide protection against any unforeseen losses.

At December 31, 2006, stockholders' equity totaled \$62.0 million, an increase of \$5.2 million from \$56.8 million at December 31, 2005. An important source of capital is earnings retention. Net income of \$8.8 million in 2006, offset by stock repurchases of \$4.2 million, was the primary factor contributing to the increase. Also affecting capital in 2006 was paid in capital in the amount of \$0.5 million resulting from a tax benefit on stock options exercised and a decrease in other comprehensive income of \$0.6 million, consisting of unrealized losses on investment securities available-for-sale and directors' and employees' retirement plan equity adjustment. The Bank's Tier 1 Leverage Capital ratio at year-end 2006 was 9.0% and 8.3% for 2005.

On April 24, 2006, the Company approved a stock repurchase program effective April 30, 2006 to replace the Company's previous stock purchase plan that expired on April 30, 2006. The stock repurchase program, which will remain in effect until April 30, 2008, allows repurchases by the Company in an aggregate of up to 2.5% of the Company's outstanding shares of common stock over each rolling twelve-month period. The Company's previous stock purchase plan had allowed repurchases by the Company in an aggregate of up to 3% of the Company's outstanding shares of common stock over each rolling twelve-month period. During 2006, the Bank paid \$2.5 million in dividends to the Company to fund the repurchase of 155,678 shares of the Company's outstanding common stock. During 2005, the Bank paid \$3.5 million in dividends to the Company to fund the repurchase of 174,979 shares of the Company's outstanding common stock. The purpose of the stock repurchase program is to give management the ability to more effectively manage capital and create liquidity for shareholders who want to sell their stock. Management believes that the stock repurchase program has been a prudent use of excess capital.

The capital of the Bank historically has been maintained at a level that is in excess of regulatory guidelines. The policy of annual stock dividends has, over time, allowed the Bank to match capital and asset growth through retained earnings and a managed program of geographic growth.

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ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk to a bank's financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. The Bank has no exposure to foreign currency exchange risk or any specific exposure to commodity price risk. The Bank's major area of market risk exposure is interest rate risk ("IRR"). The Bank's exposure to IRR can be explained as the potential for change in the Bank's reported earnings and/or the market value of its net worth. Variations in interest rates affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. Interest rate changes also affect the underlying economic value of the Bank's assets, liabilities and off-balance sheet items. These changes arise because the present value of future cash flows, and often the cash flows themselves, changes with the interest rates. The effects of the changes in these present values reflect the change in the Bank's underlying economic value and provide a basis for the expected change in future earnings related to the interest rate. IRR is inherent in the role of banks as financial intermediaries; however, a bank with a high IRR level may experience lower earnings, impaired liquidity and capital positions, and most likely, a greater risk of insolvency. Therefore, banks must carefully evaluate IRR to promote safety and soundness in their activities.

The responsibility for the Bank's market risk sensitivity management has been delegated to the Asset/Liability Committee ("ALCO"). Specifically, ALCO utilizes computerized modeling techniques to monitor and attempt to control the influence that market changes have on rate sensitive assets and rate sensitive liabilities.

Market risk continues to be a major focal point of regulatory emphasis. In accordance with regulation, each bank is required to develop an IRR management program depending on its structure, including certain fundamental components, which are mandatory to ensure IRR management. These elements include appropriate board and management oversight, as well a comprehensive risk management process that effectively identifies, measures, monitors and controls risk. Should a bank have material weaknesses in its risk management process or high exposure relative to its capital, the bank regulatory agencies will take action to remedy these shortcomings. Moreover, the level of a bank's IRR exposure and the quality of its risk management process is a determining factor when evaluating a bank's capital adequacy.

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The Bank utilizes the tabular presentation alternative in complying with quantitative and qualitative disclosure rules.

The following tables summarize the expected maturity, principal repricing, principal repayment and fair value of the financial instruments that are sensitive to changes in interest rates.

Interest Rate Sensitivity Analysis at December 31, 2006

In Thousands	Expected Maturity/Repricing/Principal Payment				Total Balance	Fair Value
	Within 1 Year	1 Year to 3 Years	3 Years to 5 Years	After 5 Years		
Interest-Sensitive Assets:						
Federal funds sold	\$ 62,470	—	—	—	62,470	62,470
Average interest rate	5.31%	—	—	—	5.31%	—
Fixed rate investments	\$ 12,298	27,799	13,692	22,484	76,273	76,273
Average interest rate	4.90%	5.22%	5.22%	6.09%	5.43%	—
Fixed rate loans ⁽¹⁾	\$ 52,221	23,571	20,637	18,169	114,598	114,665
Average interest rate	6.87%	7.30%	7.72%	6.88%	7.11%	—
Variable rate loans ⁽¹⁾	\$ 174,338	63,695	47,230	75,688	360,951	361,283
Average interest rate	8.97%	8.16%	8.13%	7.56%	8.42%	—
Loans held-for-sale	\$ 4,460	—	—	—	4,460	4,460
Average interest rate	6.35%	—	—	—	6.35%	—
Interest-Sensitive Liabilities:						
NOW account deposits ⁽²⁾	\$ 30,453	9,992	6,929	70,246	117,620	96,703
Average interest rate	1.10%	1.10%	1.10%	1.10%	1.10%	—
Money market deposits ⁽²⁾	\$ 37,513	6,431	5,359	57,875	107,178	90,573
Average interest rate	1.25%	1.25%	1.25%	1.25%	1.25%	—
Savings deposits ⁽²⁾	\$ 23,783	8,834	6,795	28,538	67,950	59,681
Average interest rate	1.65%	1.65%	1.65%	1.65%	1.65%	—
Certificates of deposit	\$ 104,673	5,535	3,228	—	113,436	113,563
Average interest rate	3.60%	3.65%	4.25%	—	3.62%	—
Borrowed funds ⁽³⁾	\$ 858	10,123	—	—	10,981	10,528
Average interest rate	5.38%	2.91%	—	—	3.11%	—
Interest-Sensitive Off-Balance Sheet Items:						
Commitments to lend	—	—	—	—	\$ 198,200	1,487
Standby letters of credit	—	—	—	—	\$ 12,222	122

(1) Based upon contractual maturity dates and interest rate repricing.

(2) NOW, money market and savings deposits do not carry contractual maturity dates. The actual maturities of NOW, money market and savings deposits could vary substantially if future withdrawals differ from the Company's historical experience.

(3) Excludes interest on fixed rate obligations.

At December 31, 2006, federal funds sold of \$62.5 million with a yield of 5.31% and investments of \$12.3 million with a weighted-average, tax equivalent yield of 4.90% were scheduled to mature within one year. In addition, net

loans (including loans held-for-sale) of \$231.0 million with a weighted-average yield of 8.45% were scheduled to mature or reprice within the same time-frame. Overall, interest-earning assets scheduled to mature within one year totaled \$305.8 million with a weighted-average, tax-equivalent yield of 7.78%. With respect to interest-bearing liabilities, based on historical withdrawal patterns, NOW accounts, money market and savings deposits of \$91.7 million with a weighted-average cost of 1.30% were scheduled to mature within one year. Certificates of deposit totaling \$104.7 million with a weighted-average cost of 3.60% were scheduled to mature in the same time-frame. In addition, borrowed funds totaling \$0.9 million with a weighted-average cost of 5.38% were scheduled to mature within one year. Total interest-bearing liabilities scheduled to mature within one year equaled \$197.3 million with a weighted-average cost of 2.54%.

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Historical withdrawal patterns with respect to interest-bearing and non-interest-bearing transaction accounts are not necessarily indicative of future performance as the volume of cash flows may increase or decrease. Loan information is presented based on payment due dates and repricing dates, which may differ materially from actual results due to prepayments.

The Bank seeks to control IRR by matching assets and liabilities. One tool used to ensure market rate return is variable rate loans. Loans totaling \$231.0 million or 48.1% of the total loan portfolio at December 31, 2006 (including loans held-for-sale) are subject to repricing within one year. Loan maturities in the after five year category decreased to \$93.9 million at December 31, 2006 from \$129.6 million at December 31, 2005.

The Bank is required by FASB 115 to mark to market the Available-for-Sale investments at the end of each quarter. Mark to market adjustments resulted in a reduction of \$112,000 in other comprehensive income as reflected in the December 31, 2006 consolidated balance sheet. Mark to market adjustments during the year ended December 31, 2005 resulted in a reduction of \$914,000 in other comprehensive income. These adjustments were the result of fluctuating interest rates.

ITEM 8 - FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

In response to this Item, the information set forth on pages 47 through 84 in this Annual Report is incorporated herein by reference.

Financial Statements Filed:

Management's Report	Page 44
Reports of Independent Registered Public Accounting Firms	Page 45
Consolidated Balance Sheets as of December 31, 2006 and 2005	Page 47
Consolidated Statements of Operations for Years ended December 31, 2006, 2005, and 2004	Page 48
Consolidated Statements of Stockholders' Equity and Comprehensive Income for Years ended December 31, 2006, 2005, and 2004	Page 49
Consolidated Statements of Cash Flows for Years ended December 31, 2006, 2005, and 2004	Page 50
Notes to Consolidated Financial Statements	Page 51

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Management's Report

**FIRST NORTHERN COMMUNITY BANCORP AND SUBSIDIARY
MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of First Northern Community Bancorp and subsidiary (the "Company") is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under the framework in Internal Control - Integrated Framework, management of the Company has concluded the Company maintained effective internal control over financial reporting, as such term is defined in Securities Exchange Act of 1934 Rules 13a-15(f), as of December 31, 2006.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management is also responsible for the preparation and fair presentation of the consolidated financial statements and other financial information contained in this report. The accompanying consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include, as necessary, best estimates and judgments by management. MOSS ADAMS LLP, an independent registered public accounting firm, has audited the Company's consolidated financial statements as of and for the year ended December 31, 2006, and the Company's assertion as to the effectiveness of internal control over financial reporting as of December 31, 2006, as stated in their reports, which are included herein.

/s/ Owen J. Onsum

Owen J. Onsum
President/Chief Executive Officer/Director
(Principal Executive Officer)

/s/ Louise A. Walker

Louise A. Walker
Senior Executive Vice President/Chief Financial Officer
(Principal Financial Officer)

March 15, 2007

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Report of Independent Registered Public Accounting Firm

To The Board of Directors and Stockholders
First Northern Community Bancorp:

We have audited the accompanying consolidated balance sheet of First Northern Community Bancorp and subsidiary (the Company) as of December 31, 2006 and the related consolidated statements of operations, stockholders' equity and comprehensive income and cash flows for the year ended December 31, 2006. We have also audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting, that the Company maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these financial statements, an opinion on management's assessment, and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of First Northern Community Bancorp and subsidiary as of December 31, 2006 and the consolidated results of their operations and cash flows for the year ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion management's assessment that First Northern Community Bancorp and subsidiary maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control -

Integrated Framework issued by the COSO. Furthermore, in our opinion, First Northern Community Bancorp and subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the COSO.

As discussed in notes 1 and 12 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for share-based payment arrangements to conform to Statement of Financial Accounting Standard No. 123(R), "Share-Based Payment".

/s/ MOSS ADAMS LLP

Stockton, California
March 15, 2007

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
First Northern Community Bancorp:

We have audited the accompanying consolidated balance sheet of First Northern Community Bancorp and subsidiary as of December 31, 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Northern Community Bancorp and subsidiary as of December 31, 2005, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Sacramento, California
March 15, 2007

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**FIRST NORTHERN COMMUNITY BANCORP
AND SUBSIDIARY**

Consolidated Balance Sheets
December 31, 2006 and 2005
(in thousands, except share amounts)

	2006	2005
Assets		
Cash and due from banks	\$ 35,531	\$ 35,507
Federal funds sold	62,470	87,185
Investment securities - available-for-sale (includes securities pledged to creditors with the right to sell or repledge of \$3,935 and \$3,963, respectively)	76,273	48,788
Loans, net	475,549	456,061
Loans held-for-sale	4,460	4,440
Premises and equipment, net	8,060	8,311
Other real estate owned	375	268
Other assets	22,507	20,087
Total assets	\$ 685,225	\$ 660,647
Liabilities and Stockholders' Equity		
Deposits:		
Demand	\$ 197,498	\$ 192,436
Interest-bearing transaction deposits	117,620	85,560
Savings and MMDAs	175,128	185,878
Time, under \$100,000	47,137	51,921
Time, \$100,000 and over	66,299	65,986
Total Deposits	603,682	581,781
FHLB advances and other borrowings	10,981	14,969
Accrued interest payable and other liabilities	8,572	7,095
Total Liabilities	623,235	603,845
Stockholders' Equity:		
Common stock, no par value; 16,000,000 shares authorized; 7,980,952 and 7,558,759 shares issued and outstanding in 2006 and 2005, respectively;	45,726	36,100
Additional paid-in capital	977	977
Retained earnings	15,792	19,606
Accumulated other comprehensive (loss) income, net	(505)	119
Total stockholders' equity	61,990	56,802
Commitments and contingencies		
Total liabilities and stockholders' equity	\$ 685,225	\$ 660,647

See accompanying notes to consolidated financial statements.

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**FIRST NORTHERN COMMUNITY BANCORP
AND SUBSIDIARY**

Consolidated Statements of Operations
Years Ended December 31, 2006, 2005 and 2004
(in thousands, except share amounts)

	2006	2005	2004
Interest income:			
Interest and fees on loans	\$ 41,894	\$ 35,838	\$ 27,873
Federal funds sold	2,986	2,587	972
Investment securities:			
Taxable	2,554	1,915	2,164
Non-taxable	636	562	610
Total interest income	48,070	40,902	31,619
Interest expense:			
Time deposits \$100,000 and over	2,315	1,452	1,122
Other deposits	6,748	3,782	1,863
Other borrowings	363	495	441
Total interest expense	9,426	5,729	3,426
Net interest income	38,644	35,173	28,193
Provision for loan losses	735	600	207
Net interest income after provision for loan losses	37,909	34,573	27,986
Other operating income:			
Service charges on deposit accounts	2,820	2,400	2,203
Net realized gains on available-for-sale securities	—	15	3
Net realized gains on loans held-for-sale	45	763	742
Net realized gains on other real estate owned	6	323	32
Other income	2,418	2,219	2,234
Total other operating income	5,289	5,720	5,214
Other operating expenses:			
Salaries and employee benefits	17,455	15,916	13,545
Occupancy and equipment	3,673	3,236	3,042
Data processing	1,384	1,209	1,079
Stationery and supplies	524	481	486
Advertising	894	736	416
Directors fees	162	128	127
Other	5,127	5,107	4,248
Total other operating expenses	29,219	26,813	22,943
Income before income tax expense	13,979	13,480	10,257
Provision for income tax expense	5,169	4,792	3,550
Net income	\$ 8,810	\$ 8,688	\$ 6,707
Basic income per share	\$ 1.04	\$ 1.02	\$ 0.78
Diluted income per share	\$ 0.99	\$ 0.98	\$ 0.76

See accompanying notes to consolidated financial statements.

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**FIRST NORTHERN COMMUNITY BANCORP
AND SUBSIDIARY**

Consolidated Statements of Stockholders' Equity and Comprehensive Income
Years Ended December 31, 2006, 2005 and 2004
(in thousands, except share amounts)

Description	Common Stock		Comprehensive Income	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amounts					
Balance at December 31, 2003	6,834,514	\$ 28,193		\$ 977	\$ 15,933	\$ 1,869	\$ 46,972
Comprehensive income:							
Net income			\$ 6,707		\$ 6,707		\$ 6,707
Other comprehensive loss:							
Unrealized holding losses arising during the current period, net of tax effect of \$513			(770)				
Reclassification adjustment due to gains realized, net of tax effect of \$1			2				
Directors' and officers' retirement plan equity adjustments			(116)				
Total other comprehensive loss, net of tax effect of \$512			2(884)			(884)	(884)
Comprehensive income			\$ 5,823				
6% stock dividend	410,214	5,537			(5,537)		
Cash in lieu of fractional shares					(12)		(12)
Stock-based compensation and related tax benefits		360					360
Common shares issued, including tax benefits	80,668	398					398
Stock repurchase and retirement	(123,062)	(1,640)					(1,640)
Balance at December 31, 2004	7,202,334	32,848		977	17,091	985	51,901
Comprehensive income:							
Net income			\$ 8,688		8,688		8,688
Other comprehensive loss:							
Unrealized holding losses arising during the current period, net of tax effect of \$615			(923)				

Reclassification adjustment due to gains realized, net of tax effect of \$6							
Directors' and officers' retirement plan equity adjustments			48				
Total other comprehensive loss, net of tax effect of \$609			(866)		(866)		(866)
Comprehensive income			\$ 7,822				
6% stock dividend	432,132	6,158			(6,158)		—
Cash in lieu of fractional shares					(15)		(15)
Stock-based compensation and related tax benefits		554					554
Common shares issued, including tax benefits	99,262	394					394
Stock repurchase and retirement	(174,969)	(3,854)					(3,854)
Balance at December 31, 2005	7,558,759	36,100		977	19,606	119	56,802
Comprehensive income:							
Net income			\$ 8,810		8,810		8,810
Other comprehensive loss:							
Unrealized holding losses arising during the current period, net of tax effect of \$75			(112)				
Reclassification adjustment due to gains realized, net of tax effect of \$-0-			—				
Directors' and officers' retirement plan equity adjustments, net of tax effect of \$341			(512)				
Total other comprehensive loss, net of tax effect of \$416			(624)		(624)		(624)
Comprehensive income			\$ 8,186				
6% stock dividend	455,472	12,525			(12,525)		—
Cash in lieu of fractional shares					(15)		(15)
Accrued compensation					(84)		(84)
Stock-based compensation and related tax benefits		817					817
Common shares issued, including tax benefits	122,399	472					472
Stock repurchase and retirement	(155,678)	(4,188)					(4,188)
Balance at December 31, 2006	7,980,952	\$ 45,726		\$ 977	\$ 15,792	\$ (505)	\$ 61,990

See accompanying notes to consolidated financial statements.

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**FIRST NORTHERN COMMUNITY BANCORP
AND SUBSIDIARY**

Consolidated Statements of Cash Flows
Years Ended December 31, 2006, 2005 and 2004
(in thousands, except share amounts)

	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 8,810	\$ 8,688	\$ 6,707
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	735	600	207
Stock plan accruals	395	286	204
Tax benefit for stock options	422	268	156
Depreciation and amortization	1,041	1,016	1,283
Accretion and amortization, net	(96)	25	60
Net realized gains on available-for-sale securities	—	(15)	(3)
Net realized gains on loans held-for-sale	(45)	(763)	(742)
Gain on sale of OREO	(6)	(323)	(32)
Gain on sale of bank premises and equipment	—	(5)	—
Benefit from deferred income taxes	(503)	(666)	(625)
Proceeds from sales of loans held-for-sale	38,386	62,428	58,387
Originations of loans held-for-sale	(38,361)	(62,386)	(56,694)
(Decrease) increase in deferred loan origination fees and costs, net	(355)	(372)	325
(Increase) decrease in accrued interest receivable and other assets	(2,016)	(1,707)	422
Increase in accrued interest payable and other liabilities	1,477	2,135	913
Net cash provided by operating activities	9,884	9,209	10,568
Cash flows from investing activities:			
Proceeds from maturities of available-for-sale securities	12,900	10,755	8,715
Proceeds from sales of available-for-sale securities	—	405	—
Principal repayments on available-for-sale securities	2,027	655	836
Purchase of available-for-sale securities	(42,503)	(6,982)	(15,807)
Net increase in loans	(19,975)	(26,855)	(54,464)
Purchases of bank premises and equipment	(790)	(1,892)	(745)
Proceeds from bank premises and equipment	—	5	—
Proceeds from sale of other real estate owned	6	323	32
Net cash used in investing activities	(48,335)	(23,586)	(61,433)
Cash flows from financing activities:			
Net increase in deposits	21,901	24,595	58,337
Net (decrease) increase in FHLB advances and other borrowings	(3,988)	(487)	5,883
Cash dividends paid in lieu of fractional shares	(15)	(15)	(12)
Common stock issued	472	394	398
Tax benefit for stock options	(422)	(268)	(156)
Repurchase of common stock	(4,188)	(3,854)	(1,640)
Net cash provided by financing activities	13,760	20,365	62,966
Net change in cash and cash equivalents	(24,691)	5,988	11,945

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Cash and cash equivalents at beginning of year		122,692		116,704		104,759
Cash and cash equivalents at end of year	\$	98,001	\$	122,692	\$	116,704

See accompanying notes to consolidated financial statements.

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**FIRST NORTHERN COMMUNITY BANCORP
AND SUBSIDIARY**

Notes to Consolidated Financial Statements
Years Ended December 31, 2006, 2005 and 2004
(in thousands, except share amounts)

(1) Summary of Significant Accounting Policies

First Northern Community Bancorp (the “Company”) is a bank holding company whose only subsidiary, First Northern Bank of Dixon (the “Bank”), a California state chartered bank, conducts general banking activities, including collecting deposits and originating loans, and serves Solano, Yolo, Sacramento, Placer and El Dorado Counties. All intercompany transactions between the Company and the Bank have been eliminated in consolidation.

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America. In preparing the consolidated 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 revenues and expenses for the period. Actual results could differ from those estimates applied in the preparation of the accompanying consolidated financial statements. For the Bank the most significant accounting estimate is the allowance for loan losses. *See* footnote (1)(e). A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements follows.

(a) Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers due from banks, federal funds sold for one-day periods and short-term bankers acceptances to be cash equivalents.

(b) Investment Securities

Investment securities consist of U.S. Treasury securities, U.S. Agency securities, obligations of states and political subdivisions, obligations of U.S. Corporations, mortgage backed securities and other securities. At the time of purchase of a security the Company designates the security as held-to-maturity or available-for-sale, based on its investment objectives, operational needs and intent to hold. The Company does not purchase securities with the intent to engage in trading activity.

Held-to-maturity securities are recorded at amortized cost, adjusted for amortization or accretion of premiums or discounts. Available-for-sale securities are recorded at fair value with unrealized holding gains and losses, net of the related tax effect, reported as a separate component of stockholders’ equity until realized.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed other than temporary results in a charge to earnings and the corresponding establishment of a new cost basis for the security. Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned. Realized gains and losses for securities classified as available-for-sale and held-to-maturity are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

Derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and hedging activities, are recognized as either assets or liabilities in the statement of financial position and measured at fair value. The Company did not hold any derivatives at December 31, 2006 and 2005.

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(c)

Loans

Loans are reported at the principal amount outstanding, net of deferred loan fees and the allowance for loan losses. A loan is considered impaired when, based on current information and events; it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement, including scheduled interest payments. For a loan that has been restructured, the contractual terms of the loan agreement refer to the contractual terms specified by the original loan agreement, not the contractual terms specified by the restructuring agreement. An impaired loan is measured based upon the present value of future cash flows discounted at the loan's effective rate, the loan's observable market price, or the fair value of collateral if the loan is collateral dependent. Interest on impaired loans is recognized on a cash basis. If the measurement of the impaired loan is less than the recorded investment in the loan, an impairment is recognized by a charge to the allowance for loan losses.

Unearned discount on installment loans is recognized as income over the terms of the loans by the interest method. Interest on other loans is calculated by using the simple interest method on the daily balance of the principal amount outstanding.

Loan fees net of certain direct costs of origination, which represent an adjustment to interest yield are deferred and amortized over the contractual term of the loan using the interest method.

Loans on which the accrual of interest has been discontinued are designated as non-accrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full and timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal. When a loan is placed on non-accrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Restructured loans are loans on which concessions in terms have been granted because of the borrowers' financial difficulties. Interest is generally accrued on such loans in accordance with the new terms.

(d)

Loans Held-for-Sale

Loans originated and held-for-sale are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income.

(e)

Allowance for Loan Losses

The allowance for loan losses is established through a provision charged to expense. Loans are charged off against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing loans and overdrafts on evaluations of collectibility and prior loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to pay. While management uses these evaluations to recognize the provision for loan losses, future provisions may be necessary based on changes in the factors used in the evaluations.

Material estimates relating to the determination of the allowance for loan losses are particularly susceptible to significant change in the near term. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, the Federal Deposit Insurance Corporation ("FDIC"), as an integral part of its examination process, periodically reviews the Bank's allowance for loan losses. The FDIC

may require the Bank to recognize additions to the allowance based on their judgment about information available to them at the time of their examination.

Table of Contents**(f) Premises and Equipment**

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed substantially by the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are depreciated over the estimated useful lives of the improvements or the terms of the related leases, whichever is shorter. The useful lives used in computing depreciation are as follows:

Buildings and improvements	15 to 50 years
Furniture and equipment	3 to 10 years

(g) Other Real Estate Owned

Other real estate acquired by foreclosure, is carried at the lower of the recorded investment in the property or its fair value less estimated selling costs. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Fair value of other real estate owned is generally determined based on an appraisal of the property. Any subsequent operating expenses or income, reduction in estimated values and gains or losses on disposition of such properties are included in other operating expenses.

Revenue recognition on the disposition of real estate is dependent upon the transaction meeting certain criteria relating to the nature of the property sold and the terms of the sale. Under certain circumstances, revenue recognition may be deferred until these criteria are met.

(h) Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(i) Gain or Loss on Sale of Loans and Servicing Rights

Retained interests in loans sold are measured by allocating the previous carrying amount of the transferred assets between the loans sold and retained interests, if any, based on their relative fair value at the date of transfer. Fair values are estimated using discounted cash flows based on a current market interest rate.

A sale is recognized when the transaction closes and the proceeds are other than beneficial interests in the assets sold. A gain or loss is recognized to the extent that the sales proceeds and the fair value of the servicing asset exceed or are less than the book value of the loan. Additionally, a normal cost for servicing the loan is considered in the determination of the gain or loss.

When servicing rights are sold, a gain or loss is recognized at the closing date to the extent that the sales proceeds, less costs to complete the sale, exceed or are less than the carrying value of the servicing rights held.

Transfers and servicing of financial assets and extinguishments of liabilities are accounted for and reported based on consistent application of a financial-components approach that focuses on control. Transfers of financial assets that are

sales are distinguished from transfers that are secured borrowings. Retained interests (mortgage servicing rights) in loans sold are measured by allocating the previous carrying amount of the transferred assets between the loans sold and retained interest, if any, based on their relative fair value at the date of transfer. Fair values are estimated using discounted cash flows based on a current market interest rate.

The Company recognizes a gain and a related asset for the fair value of the rights to service loans for others when loans are sold. The Company sold substantially all of its conforming long-term residential mortgage loans originated during the years ended December 31, 2006, 2005 and 2004 for cash proceeds equal to the fair value of the loans.

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The recorded value of mortgage servicing rights is included in other assets, and is amortized in proportion to, and over the period of, estimated net servicing revenues. The Company assesses capitalized mortgage servicing rights for impairment based upon the fair value of those rights at each reporting date. For purposes of measuring impairment, the rights are stratified based upon the product type, term and interest rates. Fair value is determined by discounting estimated net future cash flows from mortgage servicing activities using discount rates that approximate current market rates and estimated prepayment rates, among other assumptions. The amount of impairment recognized, if any, is the amount by which the capitalized mortgage servicing rights for a stratum exceeds their fair value. Impairment, if any, is recognized through a valuation allowance for each individual stratum.

The Company had mortgage loans held-for-sale of \$4,460 and \$4,440 at December 31, 2006 and 2005, respectively. At December 31, 2006 and 2005, the Company serviced real estate mortgage loans for others of \$112,742 and \$112,743, respectively.

Mortgage servicing rights as of December 31, 2006 were \$945. The balance as of December 31, 2005 was \$973.

(j)

Income Taxes

The Company accounts for income taxes under the asset and liability method. Under 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 existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. 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.

On July 15, 2002, the Bank made a \$2,355 equity investment in a partnership, which owns low-income affordable housing projects that generate tax benefits in the form of federal and state housing tax credits. On December 31, 2004, the Bank transferred the amortized cost of the equity investment to a similar equity investment partnership which owns low income affordable housing projects that generate tax benefits in the form of federal and state tax credits. As a limited partner investor in this partnership, the Company receives tax benefits in the form of tax deductions from partnership operating losses and federal and state income tax credits. The federal and state income tax credits are earned over a 10-year period as a result of the investment property meeting certain criteria and are subject to recapture for non-compliance with such criteria over a 15-year period. The expected benefit resulting from the low-income housing tax credits is recognized in the period for which the tax benefit is recognized in the Company's consolidated tax returns. This investment is accounted for using the effective yield method and is recorded in other assets on the balance sheet. Under the effective yield method, the Company recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the Company. The effective yield is the internal rate of return on the investment, based on the cost of the investment and the guaranteed tax credits allocated to the Company. Any expected residual value of the investment was excluded from the effective yield calculation. Cash received from operations of the limited partnership or sale of the property, if any, will be included in earnings when realized or realizable.

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(k) Stock Option Plan

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 123R, “Share-Based Payments,” which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options. SFAS No. 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees,” and instead generally requires that such transactions be accounted for using a fair-value based method. The Company has elected the modified prospective transition method as permitted under SFAS No. 123R, and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006. Stock-based compensation for awards granted prior to January 1, 2006 is based upon the grant-date fair value of such compensation as determined under the pro forma provisions of SFAS No. 123, “Accounting for Stock-Based Compensation.” The Company issues new shares of common stock upon the exercise of stock options. See Note 12 of Notes to Consolidated Financial Statements (page 68).

(l) Earnings Per Share (EPS)

Basic EPS includes no dilution and 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 of securities that could share in the earnings of an entity. See Note 9 of Notes to Consolidated Financial Statements (page 67).

(m) Comprehensive Income

Accounting principles generally accepted in the United States require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gain and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

(n) Fiduciary Powers

On July 1, 2002, the Bank received trust powers from applicable regulatory agencies and on that date began to offer fiduciary services for individuals, businesses, governments and charitable organizations in the Solano, Yolo, Sacramento, Placer and El Dorado County areas. The Bank’s full-service asset management and trust department, which offers and manages such fiduciary services, is located in downtown Sacramento.

(o) Impact of Recently Issued Accounting Standards

In September 2006, the SEC released Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (“SAB 108”), which is effective for fiscal years ending on or after November 15, 2006. SAB 108 provides guidance on how the effects of prior-year uncorrected financial statement misstatements should be considered in quantifying a current year misstatement. SAB 108 requires public companies to quantify misstatements using both an income statement (rollover) and balance sheet (iron curtain) approach and evaluate whether either approach results in a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. If prior year errors that had been previously considered immaterial now are considered material based on either approach, no restatement is required so long as management properly applied its previous approach and all relevant facts and circumstances were considered. Adjustments

considered immaterial in prior years under the method previously used, but now considered material under the dual approach required by SAB 108, are to be recorded upon initial adoption of SAB 108. Management has completed its review and adopted the new guidance effective January 1, 2006. The impact of the adoption was a decrease in beginning retained earnings of \$84, related to accrued vacation pay and accrued hourly compensation.

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In September 2006, the FASB issued SFAS 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 158"). SFAS 158 requires the Company to (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, (b) measure a plan's assets and its obligations that determine its funded status as of the end of the fiscal year, (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur (reported in comprehensive income) and (d) provide additional disclosure. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008.

As of December 31, 2006, the Company adopted SFAS No. 158. In accordance with this standard, the Company recorded the funded status of each of its defined benefit pension and postretirement plans as an asset or liability on its Consolidated Balance Sheet with a corresponding offset, net of taxes, recorded in Accumulated other comprehensive (loss) income within Stockholders' Equity, resulting in an after-tax decrease in equity of \$549. See Note 7 of Notes to Consolidated Financial Statements (page 60).

(p)

Reclassifications

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

(2)

Cash and Due from Banks

The Bank is required to maintain reserves with the Federal Reserve Bank based on a percentage of deposit liabilities. No aggregate reserves were required at December 31, 2006 and 2005. The Bank has met its average reserve requirements during 2006 and 2005 and the minimum required balance at December 31, 2006 and 2005.

Table of Contents**(3) Investment Securities**

The amortized cost, unrealized gains and losses and estimated market values of investments in debt and other securities at December 31, 2006 are summarized as follows:

	Amortized cost		Unrealized gains		Unrealized losses		Estimated market value
Investment securities available for sale:							
U.S. Treasury securities	\$ 249	\$	4	\$	—\$		253
Securities of U.S. government agencies and corporations	31,887		82		(266)		31,703
Obligations of states and political subdivisions	29,836		382		(25)		30,193
Mortgage backed securities	12,084		23		(76)		12,031
Total debt securities	74,056		491		(367)		74,180
Other securities	2,093		—		—		2,093
	\$ 76,149	\$	491	\$	(367)	\$	76,273

The amortized cost, unrealized gains and losses and estimated market values of investments in debt and other securities at December 31, 2005 are summarized as follows:

	Amortized cost		Unrealized gains		Unrealized losses		Estimated market value
Investment securities available for sale:							
U.S. Treasury securities	\$ 250	\$	—\$		—\$		250
Securities of U.S. government agencies and corporations	21,924		16		(384)		21,556
Obligations of states and political subdivisions	22,377		678		(8)		23,047
Mortgage backed securities	1,795		8		—		1,803
Total debt securities	46,346		702		(392)		46,656
Other securities	2,132		—		—		2,132
	\$ 48,478	\$	702	\$	(392)	\$	48,788

Gross realized gains from sales of available-for-sales securities were \$0, \$15 and \$3 for the years ended December 31, 2006, 2005 and 2004, respectively. Gross realized losses from sales of available-for-sale securities were \$0- for each of the years ended December 31, 2006, 2005 and 2004.

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The amortized cost and estimated market value of debt and other securities at December 31, 2006, by contractual maturity, are shown in the following table:

	Amortized cost	Estimated market value
Due in one year or less	\$ 12,345	12,298
Due after one year through five years	41,556	41,491
Due after five years through ten years	9,640	9,800
Due after ten years	10,515	10,591
Other	2,093	2,093
	\$ 76,149	76,273

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities due after one year through five years included mortgage-backed securities totaling \$11,996. The maturities on these securities were based on the average lives of the securities.

An analysis of gross unrealized losses of the available-for-sale investment securities portfolio as of December 31, 2006, follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Securities of U.S. government agencies and corporations	\$ 8,867	\$ (59)	\$ 14,740	\$ (207)	\$ 23,607	\$ (266)
Obligations of states and political subdivisions	3,929	(20)	225	(5)	4,154	(25)
Mortgage backed securities	8,156	(76)	—	—	8,156	(76)
Total	\$ 20,952	\$ (155)	\$ 14,965	\$ (212)	\$ 35,917	\$ (367)

No decline in value was considered “other than temporary” during 2006. The unrealized losses on investments in U.S. government agency securities were caused by market interest rate increases that occurred after these securities were purchased. Thirty-one securities that had a fair market value of \$20,952 and a total unrealized loss of \$155 have been in an unrealized loss position for less than twelve months as of December 31, 2006. In addition, sixteen securities with a fair market value of \$14,965 and a total unrealized loss of \$212 that have been in an unrealized loss position for more than twelve months as of December 31, 2006. Due to the fact the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

Investment securities carried at \$26,675 and \$22,042 at December 31, 2006 and 2005, respectively, were pledged to secure public deposits or for other purposes as required or permitted by law.

The Bank is a member of the Federal Home Loan Bank (“FHLB”) and holds stock, which is included in securities, carried at cost which approximates fair value of \$1,983 and \$2,022 at December 31, 2006 and 2005, respectively.

Table of Contents**(4) Loans**

The composition of the Bank's loan portfolio at December 31, is as follows:

	2006	2005
Commercial	\$ 99,138	88,816
Agriculture	39,346	33,458
Real estate:		
Mortgage	231,920	233,049
Commercial and Construction	108,795	105,472
Installment and other loans	5,470	4,297
	484,669	465,092
Allowance for loan losses	(8,361)	(7,917)
Net deferred origination fees and costs	(759)	(1,114)
Loans, net	\$ 475,549	456,061

As of December 31, 2006, approximately 22% of the Bank's loans are for real estate construction. Additionally approximately 48% of the Bank's loans are mortgage type loans which are secured by residential real estate. Approximately 29% of the Bank's loans are for general commercial uses including professional, retail, agricultural and small businesses. Generally, real estate loans are secured by real property and other loans are secured by funds on deposit, business or personal assets. Repayment is generally expected from the proceeds of the sales of property for real estate construction loans, and from cash flows of the borrower for other loans. The Bank's access to this collateral is through foreclosure and/or judicial procedures. The Bank's exposure to credit loss if the real estate or other security proved to be of no value is the outstanding loan balance.

Loans that were sold and were being serviced by the Bank totaled approximately \$112,742 and \$112,743 at December 31, 2006 and 2005, respectively.

Non-accrual loans totaled approximately \$3,399 and \$2,073 at December 31, 2006 and 2005, respectively. If interest on these non-accrual loans had been accrued, such income would have approximated \$280 and \$101 during the years ended December 31, 2006 and 2005, respectively.

Loans 90 days past due and still accruing totaled approximately \$37 and \$178 at December 31, 2006 and 2005, respectively.

The Bank did not restructure any loans in 2006 or 2005.

Impaired loans are loans for which it is probable that the Bank will not be able to collect all amounts due. Impaired loans totaled approximately \$3,399 and \$2,073 at December 31, 2006 and 2005, respectively, and had related valuation allowances of approximately \$122, and \$201 at December 31, 2006 and 2005, respectively. The average outstanding balance of impaired loans was approximately \$2,710, \$3,221, and \$2,108, on which \$113, \$100, and \$64 of interest income was recognized for the years ended December 31, 2006, 2005 and 2004, respectively.

Loans in the amount of \$161,222 and \$163,385 at December 31, 2006 and 2005, respectively, were pledged under a blanket collateral lien to secure actual and potential borrowings from the Federal Home Loan Bank.

Changes in the allowance for loan losses for the following years ended December 31, are summarized as follows:

2006	2005	2004
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Balance, beginning of year	\$	7,917	7,445	7,006
Provision for loan losses		735	600	207
Loans charged-off		(1,060)	(855)	(382)
Recoveries of loans previously charged-off		769	727	614
Balance, end of year	\$	8,361	7,917	7,445

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Table of Contents**(5) Premises and Equipment**

Premises and equipment consist of the following at December 31 of the indicated years:

	2006	2005
Land	\$ 2,718	\$ 2,718
Buildings	4,484	4,454
Furniture and equipment	10,325	9,639
Leasehold improvements	1,539	1,465
	19,066	18,276
Less accumulated depreciation	11,006	9,965
	\$ 8,060	\$ 8,311

Depreciation and amortization expense, included in occupancy and equipment expense, is \$1,041, \$1,016 and \$1,016 for the years ended December 31, 2006, 2005 and 2004, respectively.

(6) Other Assets

Other assets consisted of the following at December 31 of the indicated years:

	2006	2005
Accrued interest	\$ 3,832	\$ 3,119
Software, net of amortization	346	421
Officer's Life Insurance	9,995	9,159
Prepaid and other	2,900	2,872
Investment in Limited Partnerships	1,747	1,875
Deferred tax assets, net (see note 8)	3,687	2,641
	\$ 22,507	\$ 20,087

The Company amortizes capitalized software costs on a straight-line basis using a useful life from three to five years.

Software amortization expense, included in other operating expense, is \$243, \$248 and \$267 for the years ended December 31, 2006, 2005 and 2004, respectively.

The Bank held other real estate owned (OREO) in the amount of \$375 and \$268 as of December 31, 2006 and 2005, respectively. The Bank had no allowance for losses on OREO recorded for these years.

(7) Supplemental Compensation Plans**EXECUTIVE SALARY CONTINUATION PLAN****Pension Benefit Plans**

On July 19, 2001, the Company and the Bank approved an unfunded non-contributory defined benefit pension plan ("Salary Continuation Plan") and related split dollar plan for a select group of highly compensated employees. The plan

provides defined benefit levels between \$50 and \$125 depending on responsibilities at the Bank. The retirement benefits are paid for 10 years following retirement at age 65. Reduced retirement benefits are available after age 55 and 10 years of service.

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Additionally, the Company and the Bank adopted a new supplemental executive retirement plan (“SERP”) in 2006. The new plan is intended to integrate the various forms of retirement payments offered to executives. There are currently two participants in the plan.

The plan benefit is calculated using 3-year average salary plus 7-year average bonus (average compensation). For each year of service the benefit formula credits 2% of average compensation (2.5% for the CEO) up to a maximum of 50%. Therefore, for an executive serving 25 years (20 for the CEO), the target benefit is 50% of average compensation.

The target benefit is reduced for other forms of retirement income provided by the bank. Reductions are made for 50% of the social security benefit expected at age 65 and for the accumulated value of contributions the bank makes to the executive’s profit sharing plan. For purposes of this reduction, contributions to the profit sharing plan are accumulated each year at a 3-year average of the yields on 10-year treasury securities. Retirement benefits are paid monthly for 120 months plus 6 months for each full year of service over 10 years, up to a maximum of 180 months.

Reduced benefits are payable for retirement prior to age 65. Should retirement occur prior to age 65, the benefit determined by the formula described above is reduced 5% for each year payments commence prior to age 65. Therefore, the new SERP benefit is reduced 50% for retirement at age 55. No benefit is payable for voluntary terminations prior to age 55.

Eligibility to participate in the Plan is limited to a select group of management or highly compensated employees of the bank that are designated by the Board.

The Bank uses a December 31 measurement date for these plans.

	For the Year Ended December 31,		
	2006	2005	2004
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 1,079	\$ 885	\$ 596
Service cost	183	160	156
Interest cost	65	53	47
Amendments	798	—	—
Plan loss (gain)	(40)	(19)	86
Benefits Paid	(45)	—	—
Benefit obligation at end of year	\$ 2,040	\$ 1,079	\$ 885
Change in plan assets			
Employer Contribution	\$ 45	\$ —	\$ —
Benefits Paid	(45)	—	—
Fair value of plan assets at end of year	\$ —	\$ —	\$ —
Reconciliation of funded status			
Funded status	\$ (2,040)	\$ (1,079)	\$ (885)
Unrecognized net plan loss (gain)	(19)	21	40
Unrecognized prior service cost	933	148	161
Net amount recognized	\$ (1,126)	\$ (910)	\$ (684)
Amounts recognized in the consolidated balance sheets consist of:			

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Accrued benefit liability	\$	(2,040)	\$	(1,079)	\$	(885)
Intangible asset		—		148		161
Accumulated other comprehensive income		914		21		40
Net amount recognized	\$	(1,126)	\$	(910)	\$	(684)

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	For the Year Ended December 31,		
	2006	2005	2004
Components of net periodic benefit cost			
Service cost	\$ 183	\$ 160	\$ 156
Interest cost	65	54	47
Amortization of prior service cost	13	13	13
Net periodic benefit cost	261	227	216
Additional amounts recognized	—	—	—
Total benefit cost	\$ 261	\$ 227	\$ 216

Additional Information

Minimum benefit obligation at year end	\$ 2,040	\$ 1,079	\$ 885
Increase (decrease) in minimum liability included in other comprehensive income	\$ 893	\$ (19)	\$ 40

Assumptions used to determine benefit obligations at December 31

	2006	2005	2004
Discount rate used to determine net periodic benefit cost for years ended December 31	5.30%	5.10%	6.25%
Discount rate used to determine benefit obligations at December 31	5.40%	5.30%	5.10%
Future salary increases	6.00%	—	—

Plan Assets

The Bank informally funds the liabilities of this plan through life insurance purchased on the lives of plan participants. This informal funding does not meet the definition of plan assets within the meaning of pension accounting standards. Therefore, assets held for this purpose are not disclosed as part of the Salary Continuation Plan.

Cash Flows**Contributions and Estimated Benefit Payments**

For unfunded plans, contributions to the plan are the benefit payments made to participants. The Bank paid \$45,120 benefit payments during fiscal 2006. The following benefit payments, which reflect expected future service, are expected to be paid in future fiscal years:

<u>Year ending</u> <u>December 31,</u>	<u>Pension Benefits</u>
2007	\$54
2008	54
2009	54
2010	197
2011	197
2012-2016	1,151

Disclosure of settlements and curtailments:

There were no events during fiscal 2006 that would constitute a curtailment or settlement within the meaning of SFAS No. 88.

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Table of Contents**Impact of Adopting SFAS No. 158 at December 31, 2006:****Reconciliation of funded status**

	Before Adoption	Impact	After Adoption
Funded Status	\$ (2,040)	\$ —	\$ (2,040)
Unrecognized net plan loss (gain)	(19)	—	(19)
Unrecognized prior service cost	933	—	933
Net amount recognized	\$ (1,126)	\$ —	\$ (1,126)

Amounts recognized in the statement of financial position consist of:

Accrued benefit liability	\$ (1,725)	\$ (315)	\$ (2,040)
Intangible asset	599	(599)	—
Accumulated other comprehensive income	—	914	914
Fair value of plan assets at end of year	\$ (1,126)	\$ —	\$ (1,126)

DIRECTORS' RETIREMENT PLAN**Pension Benefit Plans**

On July 19, 2001, the Company and the Bank approved an unfunded non-contributory defined benefit pension plan ("Directors' Retirement Plan") and related split dollar plan for the directors of the bank. The plan provides a retirement benefit equal to \$1 per year of service as a director, up to a maximum benefit amount of \$15. The retirement benefit is payable for 10 years following retirement at age 65. Reduced retirement benefits are available after age 55 and 10 years of service.

The Bank uses a December 31 measurement date for this plan.

	For the Year Ended December 31,		
	2006	2005	2004
Change in benefit obligation			
Benefit obligation at beginning of year	\$ 402	\$ 347	\$ 244
Service cost	54	73	71
Interest cost	24	21	19
Plan loss (gain)	4	(23)	28
Benefits paid	(15)	(15)	(15)
Benefit obligation at end of year	\$ 469	\$ 403	\$ 347
Change in plan assets			
Employer contribution	\$ 15	\$ 15	\$ 15
Benefits paid	(15)	(15)	(15)
Fair value of plan assets at end of year	\$ —	\$ —	\$ —
Reconciliation of funded status			
Funded status	\$ (469)	\$ (403)	\$ (347)
Unrecognized net plan loss	50	47	76
Net amount recognized	\$ (419)	\$ (356)	\$ (271)
Amounts recognized in the statement of financial position consist of:			
Accrued benefit liability	\$ (469)	\$ (403)	\$ (347)

Accumulated other comprehensive income		50		47		76
Net amount recognized	\$	(419)	\$	(356)	\$	(271)

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For the Year Ended December 31,
2006 2005 2004

Components of net periodic benefit cost

Service cost	\$ 54	\$ 73	\$ 71
Interest cost	24	21	19
Recognized actuarial (gain)/loss	1	5	3
Net periodic benefit cost	79	99	93
Additional amounts recognized	—	—	—
Total benefit cost	\$ 79	\$ 99	\$ 93

Additional Information

Minimum benefit obligation at year end	\$ 469	\$ 403	\$ 347
Increase (decrease) in minimum liability included in other comprehensive loss	\$ 3	\$ (28)	\$ 25

Assumptions used to determine benefit obligations at December 31

	2006	2005	2004
Discount rate used to determine net periodic benefit cost for years ended December 31	5.30%	5.10%	6.25%
Discount rate used to determine benefit obligations at December 31	5.20%	5.30%	5.10%

Plan Assets

The Bank informally funds the liabilities of this plan through life insurance purchased on the lives of plan participants. This informal funding does not meet the definition of plan assets within the meaning of pension accounting standards. Therefore, assets held for this purpose are not disclosed as part of the Director's Retirement Plan.

Cash Flows**Contributions and Estimated Benefit Payments**

For unfunded plans, contributions to the plan are the benefit payments made to participants. The Bank paid \$15 in benefit payments during fiscal 2006. The following benefit payments, which reflect expected future service, are expected to be paid in future fiscal years:

<u>Year ending</u> <u>December 31,</u>	<u>Pension Benefits</u>
2007	\$15
2008	21
2009	45
2010	59
2011	70
2012-2016	369

Disclosure of settlements and curtailments:

There were no events during fiscal 2006 that would constitute a curtailment or settlement within the meaning of SFAS No. 88.

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Table of Contents**Impact of Adopting SFAS No. 158 at December 31, 2006:****Reconciliation of funded status**

	Before Adoption	Impact	After Adoption
Funded Status	\$ (469)	\$ —	\$ (469)
Unrecognized net plan loss	50	—	50
Net amount recognized	\$ (419)	\$ —	\$ (419)

Amounts recognized in the statement of financial position consist of:

Accrued benefit liability	\$ (469)	\$ —	\$ (469)
Accumulated other comprehensive income	50	—	50
Fair value of plan assets at end of year	\$ (419)	\$ —	\$ (419)

EXECUTIVE ELECTIVE DEFERRED COMPENSATION PLAN — 2001 EXECUTIVE DEFERRAL PLAN.

On July 19, 2001, the Bank approved a revised Executive Elective Deferred Compensation Plan, — the 2001 Executive Deferral Plan previously called “1995 Executive Deferral Plan”, for certain officers to provide them the ability to make elective deferrals of compensation due to tax-law limitations on benefit levels under qualified plans. Deferred amounts earn interest at an annual rate determined by the Bank’s Board. The plan is a non-qualified plan funded with bank owned life insurance policies taken on the life of the officer. During the year ended December 31, 2001, the Bank purchased insurance making a single-premium payment aggregating \$1,125, which is reported in other assets. The Bank is the beneficiary and owner of the policies. The cash surrender value of the related insurance policies as of December 31, 2006 and 2005 totaled \$1,758 and \$1,699, respectively. The accrued liability for the plan as of December 31, 2006 and 2005 totaled \$252 and \$91, respectively. The expenses for the plan for the years ended December 31, 2006, 2005 and 2004 totaled \$43, \$30 and \$30, respectively.

DIRECTOR ELECTIVE DEFERRED FEE PLAN — 2001 DIRECTOR DEFERRAL PLAN.

On July 19, 2001, the Bank approved a Director Elective Deferred Fee Plan, — the 2001 Director Deferral Plan for directors to provide them the ability to make elective deferrals of fees. Deferred amounts earn interest at annual rate determined by the Bank’s Board. The plan is a non-qualified plan funded with bank owned life insurance policies taken on the life of the director. The Bank is the beneficiary and owner of the policies. The cash surrender value of the related insurance policies as of December 31, 2006 and 2005 totaled \$93 and \$90, respectively. The accrued liability for the plan as of December 31, 2006 and 2005 totaled \$5 and \$4, respectively. The expenses for the plan for the years ended December 31, 2006, 2005 and 2004 totaled \$1, \$1 and \$1, respectively.

Table of Contents**(8) Income Taxes**

The provision for income tax expense consists of the following for the years ended December 31:

	2006	2005	2004
Current:			
Federal	\$ 4,461	\$ 4,076	\$ 3,193
State	1,211	1,382	982
	5,672	5,458	4,175
Deferred:			
Federal	(112)	(488)	(495)
State	(391)	(178)	(130)
	(503)	(666)	(625)
	\$ 5,169	\$ 4,792	\$ 3,550

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 consist of:

	2006	2005
Deferred tax assets:		
Allowance for loan losses	\$ 3,844	\$ 3,326
Deferred compensation	336	230
Retirement compensation	629	521
Stock option compensation	439	276
Post retirement benefits	386	276
Current state franchise taxes	284	454
Non-accrual interest	43	13
Other	6	—
Deferred tax assets	5,967	4,820
Less valuation allowance	—	(83)
Total deferred tax assets	5,967	4,737
Deferred tax liabilities:		
Fixed assets	1,506	1,683
FHLB dividends	170	141
Tax credit - loss on passthrough	212	42
Deferred loan costs	231	—
Other	111	106
Investment securities unrealized gains	50	124
Total deferred tax liabilities	2,280	2,096
Net deferred tax assets (see note 6)	\$ 3,687	\$ 2,641

Based upon the level of historical taxable income and projections for future taxable income over the periods during which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences.

	2006	2005	2004
Income tax expense at statutory rates	\$ 4,753	\$ 4,583	\$ 3,487
Reduction for tax exempt interest	(213)	(205)	(207)

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State franchise tax, net of federal income tax benefit	541	750	734
CSV of life insurance	(114)	(90)	(119)
Other	202	(246)	(345)
	\$ 5,169	\$ 4,792	\$ 3,550

A reconciliation of income taxes computed at the federal statutory rate of 34% and the provision for income taxes as follows:

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Table of Contents**(9) Outstanding Shares and Earnings Per Share**

On January 25, 2007, the Board of Directors of the Company declared a 6% stock dividend payable as of March 30, 2007 to shareholders of record as of February 28, 2007. All income per share amounts have been adjusted to give retroactive effect to stock dividends and stock splits.

Earnings Per Share (“EPS”)

Basic and diluted earnings per share for the years ended December 31, were computed as follows:

	2006	2005	2004
Basic earnings per share:			
Net income	\$ 8,810	\$ 8,688	\$ 6,707
Weighted average common shares outstanding	8,468,643	8,531,880	8,585,409
Basic EPS	\$ 1.04	\$ 1.02	\$ 0.78
Diluted earnings per share:			
Net income	\$ 8,810	\$ 8,688	\$ 6,707
Weighted average common shares outstanding	8,468,643	8,531,880	8,585,409
Effect of dilutive options	414,282	349,716	224,507
Diluted EPS	\$ 0.99	\$ 0.98	\$ 0.76

Table of Contents**(10) Related Party Transactions**

The Bank, in the ordinary course of business, has loan and deposit transactions with directors and executive officers. In management's opinion, these transactions were on substantially the same terms as comparable transactions with other customers of the Bank. The amount of such deposits totaled approximately \$2,338 and \$2,339 at December 31, 2006 and 2005, respectively.

The following is an analysis of the activity of loans to executive officers and directors for the years ended December 31:

	2006		2005		2004
Outstanding balance, beginning of year	\$ 304	\$	217	\$	1,187
Credit granted	58		626		578
Repayments	(89)		(539)		(1,548)
Outstanding balance, end of year	\$ 273	\$	304	\$	217

(11) Profit Sharing Plan

The Bank maintains a profit sharing plan for the benefit of its employees. Employees who have completed 12 months and 1,000 hours of service are eligible. Under the terms of this plan, a portion of the Bank's profits, as determined by the Board of Directors, will be set aside and maintained in a trust fund for the benefit of qualified employees. Contributions to the plan, included in salaries and employee benefits in the consolidated statements of operations, were \$1,607, \$1,569 and \$1,207 in 2006, 2005 and 2004, respectively.

(12) Stock Compensation Plans

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payments," which addresses the accounting for stock-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options. SFAS No. 123R eliminates the ability to account for stock-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and instead generally requires that such transactions be accounted for using a fair-value based method. The Company has elected the modified prospective transition method as permitted under SFAS No. 123R, and accordingly prior periods have not been restated to reflect the impact of SFAS No. 123R. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options that are ultimately expected to vest as the requisite service is rendered beginning on January 1, 2006. Stock-based compensation for awards granted prior to January 1, 2006 is based upon the grant-date fair value of such compensation as determined under the pro forma provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." The Company issues new shares of common stock upon the exercise of stock options.

Prior to the adoption of SFAS No. 123R, the Company during the first quarter of fiscal 2003, adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123, for stock-based employee compensation, effective as of the beginning of the fiscal year. Under the prospective method of adoption selected by the Company, stock-based employee compensation recognized for all stock options granted after January 1, 2003 is based on the fair value recognition provisions of Statement 123. For stock options issued prior to January 1, 2003, the Company is using the intrinsic value method, under which compensation expense is recorded on the date of

grant only if the current market price of the underlying stock exceeds the exercise price. The following table illustrates the effect on net income and earnings per share as if the fair value based method had been applied to all outstanding and unvested awards in each period.

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The following table presents basic and diluted EPS for the years ended December 31, 2005 and 2004.

	2005	2004
Net income as reported	\$ 8,688	\$ 6,707
Add: Stock-based employee compensation included in reported net income, net of related tax effects	286	204
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(367)	(363)
Net income Pro forma under SFAS No. 123	\$ 8,607	\$ 6,548
Basic earnings per share:		
As reported	\$ 1.02	\$ 0.78
Pro forma under SFAS No. 123	\$ 1.01	\$ 0.76
Diluted earnings per share:		
As reported	\$ 0.98	\$ 0.76
Pro forma under SFAS No. 123	\$ 0.97	\$ 0.74

As of December 31, 2006, the Company has the following share-based compensation plans:

The Company has two fixed stock option plans. Under the 2000 Employee Stock Option Plan, the Company may grant options to an employee for an amount up to 25,000 shares of common stock each year. There are 1,657,746 shares authorized under the plan. The plan will terminate February 27, 2007. The Compensation Committee of the Board of Directors is authorized to prescribe the terms and conditions of each option, including exercise price, vestings or duration of the option. Generally, options vest at a rate of 25% per year after the first anniversary of the date of grant. Options are granted at the fair value of the related common stock on the date of grant.

Under the 2000 Outside Directors Non-statutory Stock Option Plan, the Company may grant options to an outside director for an amount up to 19,881 shares of common stock during the director's lifetime. There are 497,315 shares authorized under the Plan. The Plan will terminate February 27, 2007. The exercise price of each option equals the fair value of the Company's stock on the date of grant, and an option's maximum term is five years. Options vest at the rate of 20% per year beginning on the grant date. Other than a grant of 19,881 shares to a new director, any future grants require stockholder approval.

Stock option activity for the employee and outside director's stock option plans during the years indicated is as follows:

Employee stock option plan		Outside directors stock option plan	
Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price

Balance at December 31, 2005	602,696	8.84	—	—
Granted	57,790	24.98	—	—
Exercised	(132,108)	7.52	—	—
Cancelled	(10,425)	10.48	—	—
Balance at December 31, 2006	517,953	\$ 10.94	—	\$ —

The 2000 Employee Stock Option Plan permits stock-for-stock exercises of shares. During 2006, employees tendered 29,959 (adjusted for stock options exercised before stock dividend) mature shares in stock-for-stock exercises. Matured shares are those held by employees longer than six months.

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The following table presents information on stock options for the year ended December 31, 2006:

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Options exercised	132,108	\$ 7.52	\$ 2,427	
Stock options fully vested and expected to vest:	517,953	\$ 10.94	\$ 6,246	5.90
Stock options vested and currently exercisable:	334,849	\$ 8.12	\$ 4,899	4.78

The weighted average fair value per share of options granted during the years ended December 31 was \$7.75 in 2006, \$3.98 in 2005 and \$3.33 in 2004.

At December 31, 2006, the range of exercise prices for all outstanding options ranged from \$4.27 to \$27.75.

The following table provides certain information with respect to stock options outstanding at December 31, 2006:

Range of exercise prices	Stock options outstanding	Weighted average exercise price	Weighted average remaining contractual life
Under \$ 11.10	373,972	\$ 8.19	4.90
\$ 11.10 to \$ 16.65	80,891	12.89	8.02
\$ 16.65 to \$ 24.97	54,590	24.30	9.04
\$ 24.97 to \$ 27.75	8,500	27.57	9.41
	517,953	\$ 10.94	5.90

The following table provides certain information with respect to stock options exercisable at December 31, 2006:

Range of exercise prices	Stock options exercisable	Weighted average exercise price
Under \$ 11.10	313,298	\$ 8.19
\$ 11.10 to \$ 16.65	20,226	12.89
\$ 16.65 to \$ 24.97	1,325	22.17
	334,849	\$ 8.12

As of December 31, 2006, there was \$646 of total unrecognized compensation related to non-vested stock options. This cost is expected to be recognized over a weighted average period of approximately 1.6 years.

The Company determines fair value at grant date using the Black-Scholes-Merton pricing model that takes into account the stock price at the grant date, the exercise price, the risk free interest rate, the volatility of the underlying stock and the expected life of the option.

The weighted average assumptions used in the pricing model are noted in the following table. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on both the implied volatilities from the traded option on the Company's stock and historical volatility on the Company's stock.

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For options granted prior to January 1, 2006, and valued in accordance with FAS 123, the expected volatility used to estimate the fair value of the options was based solely on the historical volatility of First Northern Bank's (the "Bank") stock. The Bank recognized option forfeitures as they occurred.

The Bank expenses the fair value of the option on a straight line basis over the vesting period. The Bank estimates forfeitures and only recognizes expense for those shares expected to vest. The Bank's estimated forfeiture rate for 2006, based on historical forfeiture experience, is approximately 0.0%.

The following table shows our weighted average assumptions used in valuing stock options granted for the years ended December 31:

	2006	2005	2004
Risk Free Interest Rate	4.57%	3.73%	3.76%
Expected Dividend Yield	0.00%	0.00%	0.00%
Expected Life in Years	4.67	6.00	6.00
Expected Price Volatility	26.39%	26.04%	23.80%

Employee Stock Purchase Plan

Under the First Northern Community Bancorp 2006 Amended Employee Stock Purchase Plan (the "Plan"), the Company is authorized to issue to an eligible employee shares of common stock. There are 250,000 shares authorized under the Plan. The Plan will terminate March 15, 2016. The Plan is implemented by participation periods of not more than twenty-seven months each. The Board of Directors determines the commencement date and duration of each participation period. An eligible employee is one who has been continually employed for at least ninety (90) days prior to commencement of a participation period. Under the terms of the Plan, employees can choose to have up to 10 percent of their compensation withheld to purchase the Company's common stock each participation period. The purchase price of the stock is 85 percent of the lower of the fair market value on the last trading day before the Date of Participation or the fair market value on the last trading day during the participation period. Approximately 73 percent of eligible employees are participating in the Plan in the current participation period, which began November 24, 2006 and will end November 23, 2007.

The First Northern Community Bancorp 2006 Amended Employee Stock Purchase Plan replaced the 2000 Employee Stock Purchase Plan. Under the 2000 Plan, at the annual stock purchase date of November 23, 2006, there were \$250 in contributions, and 22,784 shares were purchased at an average price of \$10.95, totaling \$249.

Table of Contents**(13) Short-Term and Long-Term Borrowings**

Short-term borrowings at December 31, 2006 and 2005 consisted of secured borrowings from the U.S. Treasury in the amounts of \$858 and \$1,476, respectively. The funds are placed at the discretion of the U.S. Treasury and are callable on demand by the U.S. Treasury.

Additional short-term borrowings available to the Company consist of a line of credit and advances with the Federal Home Loan Bank ("FHLB") secured under terms of a blanket collateral agreement by a pledge of FHLB stock and certain other qualifying collateral such as commercial and mortgage loans. At December 31, 2006, the Company had a current collateral borrowing capacity with the FHLB of \$93,832. The Company also has unsecured formal lines of credit totaling \$25,700 with correspondent banks and borrowing capacity of \$2,000 with the Federal Reserve Bank (loans and discounts), which is fully collateralized, with a pledge of U.S. Agency Notes.

Long-term borrowings consisted of Federal Home Loan Bank advances, totaling \$10,124 and \$13,493, respectively, at December 31, 2006 and 2005. Such advances ranged in maturity from 1.4 years to 2.3 years at a weighted average interest rate of 2.91% at December 31, 2006. Maturity ranged from 0.3 years to 3.3 years at a weighted average interest rate of 3.48% at December 31, 2005. Average outstanding balances were \$10,776 and \$13,628, respectively, during 2006 and 2005. The weighted average interest rate paid was 3.15% in 2006 and 3.48% in 2005.

(14) Commitments and Contingencies

The Company is obligated for rental payments under certain operating lease agreements, some of which contain renewal options. Total rental expense for all leases included in net occupancy and equipment expense amounted to approximately \$1,294, \$1,058, and \$921 for the years ended December 31, 2006, 2005 and 2004, respectively. At December 31, 2006, the future minimum payments under non-cancelable operating leases with initial or remaining terms in excess of one year are as follows:

Year ending December 31:	
2007	\$ 1,212
2008	1,312
2009	1,021
2010	753
2011	512
Thereafter	1,735
	\$ 6,545

At December 31, 2006, the aggregate maturities for time deposits are as follows:

Year ending December 31:	
2007	\$ 104,675
2008	4,256
2009	1,278
2010	2,953
2011	274
Thereafter	—
	\$ 113,436

The Company is subject to various legal proceedings in the normal course of its business. In the opinion of management, after having consulted with legal counsel, the outcome of the legal proceedings should not have a

material effect on the consolidated financial condition or results of operations of the Company.

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Table of Contents**(15) Financial Instruments with Off-Balance Sheet Risk**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans or through standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments, whose contract amounts represent credit risk at December 31 of the indicated periods, are as follows:

	2006	2005
Undisbursed loan commitments	\$ 198,200	203,101
Standby letters of credit	12,222	14,077
	\$ 210,422	217,178

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. Since many of the commitments are expected to expire without being drawn upon the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness 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. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

The Bank issues both financial and performance standby letters of credit. The financial standby letters of credit are primarily to guarantee payment to third parties. At December 31, 2006 there were no financial standby letters of credit outstanding. The performance standby letters of credit are typically issued to municipalities as specific performance bonds. At December 31, 2006, there was \$12,222 issued in performance standby letters of credit and the Bank carried no liability. The terms of the guarantees will expire primarily in 2007. The Bank has experienced no draws on these letters of credit, and does not expect to in the future; however, should a triggering event occur, the Bank either has collateral in excess of the letter of credit or imbedded agreements of recourse from the customer. The Bank has set aside a reserve for unfunded commitments in the amount of \$950, which is recorded in "accrued interest payable and other liabilities."

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.

Commitments to extend credit and standby letters of credit bear similar credit risk characteristics as outstanding loans. As of December 31, 2006, the Company has no off-balance sheet derivatives requiring additional disclosure.

Table of Contents**(16) Capital Adequacy and Restriction on Dividends**

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company'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).

First, a bank must meet a minimum Tier I Capital ratio (as defined in the regulations) ranging from 3% to 5% based upon the bank's CAMELS (capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk) rating.

Second, a bank must meet minimum Total Risk-Based Capital to risk-weighted assets ratio of 8%. Risk-based capital and asset guidelines vary from Tier I capital guidelines by redefining the components of capital, categorizing assets into different risk classes, and including certain off-balance sheet items in the calculation of the capital ratio. The effect of the risk-based capital guidelines is that banks with high exposure will be required to raise additional capital while institutions with low risk exposure could, with the concurrence of regulatory authorities, be permitted to operate with lower capital ratios. In addition, a bank must meet minimum Tier I Capital to average assets ratio.

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 Deposit Insurance Corporation ("FDIC") categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must meet the minimum ratios as set forth above. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company and the Bank had Tier I, total capital and Tier I leverage above the well capitalized levels at December 31, 2006 and 2005, respectively, as set forth in the following tables:

	The Company			
	2006		2005	
	Amount	Ratio	Amount	Ratio
Total Risk-Based Capital (to Risk Weighted Assets)	\$ 69,078	12.3%	\$ 62,824	11.8%
Tier I Capital (to Risk Weighted Assets)	62,400	11.1%	56,438	10.6%
Tier I Leverage Capital (to Average Assets)	62,400	9.1%	56,438	8.5%

	The Bank			
	2006		2005	
	Amount	Ratio	Amount	Ratio

Total Risk-Based Capital (to Risk Weighted Assets)	\$	68,397	12.2%	\$	61,672	11.6%
Tier I Capital (to Risk Weighted Assets)		61,719	11.0%		55,287	10.4%
Tier I Leverage Capital (to Average Assets)		61,719	9.0%		55,287	8.3%

Cash dividends declared by the Bank are restricted under California State banking laws to the lesser of the Bank's retained earnings or the Bank's net income for the latest three fiscal years, less dividends previously declared during that period.

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(17) Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amounts reported in the balance sheet for cash and short-term instruments are a reasonable estimate of fair value.

Investment Securities

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

Loans Receivable

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., commercial real estate and rental property mortgage loans, commercial and industrial loans, and agricultural loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. The carrying amount of accrued interest receivable approximates its fair value.

Commitments to Extend Credit and Standby Letters of Credit

The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligation with the counterparties at the reporting date.

Deposit Liabilities

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits. The carrying amount of accrued interest payable approximates its fair value.

FHLB Advances and Other Borrowings

The fair values of borrowed funds were estimated by discounting future cash flows related to these financial instruments using current market rates for financial instruments with similar characteristics.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a

significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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Fair value estimates are based on existing on-and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred tax liabilities and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in many of the estimates.

The estimated fair values of the Company's financial instruments for the years ended December 31 are approximately as follows:

	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:				
Cash and federal funds sold	\$ 98,001	\$ 98,001	\$ 122,692	\$ 122,692
Investment securities	76,273	76,273	48,788	48,788
Loans:				
Net loans	475,549	475,948	456,061	457,858
Loans held-for-sale	4,460	4,460	4,440	4,440
Financial liabilities:				
Deposits	603,682	507,688	581,781	496,881
FHLB advances and other borrowings	10,981	10,528	14,969	14,416
		Contract amount	2006 Carrying amount	Fair value
Unrecognized financial instruments:				
Commitments to extend credit	\$ 198,200	\$ 951	\$ 1,487	
Standby letters of credit	\$ 12,222	\$ —	\$ 122	
		Contract amount	2005 Carrying amount	Fair value
Unrecognized financial instruments:				
Commitments to extend credit	\$ 203,101	\$ 975	\$ 1,523	
Standby letters of credit	\$ 14,077	\$ —	\$ 141	

Table of Contents**(18) Supplemental Consolidated Statements of Cash Flows Information**

Supplemental disclosures to the Consolidated Statements of Cash Flows for the years ended December 31, are as follows:

	2006	2005	2004
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	\$ 9,243	\$ 5,641	\$ 3,417
Income taxes	\$ 6,165	\$ 6,946	\$ 3,931
Supplemental disclosure of non-cash investing and financing activities:			
Accrued compensation	\$ (84)	\$ —	—
Stock dividend distributed	\$ 12,525	\$ 6,158	\$ 5,537
Loans held-for-sale transferred to loans	\$ —	\$ —	\$ 6,002
Loans held-for-investment transferred to other real estate owned	\$ 375	\$ 268	\$ —

(19) Quarterly Financial Information (Unaudited)

	March 31,	June 30,	September 30,	December 31,
2006:				
Interest income	\$ 11,331	\$ 11,896	\$ 12,408	\$ 12,435
Net interest income	9,372	9,776	9,857	9,619
Provision for loan losses	(575)	350	810	150
Other operating income	1,209	1,363	1,446	1,271
Other operating expense	7,327	7,141	7,250	7,501
Income before taxes	3,849	3,648	3,243	3,239
Net income	2,402	2,294	2,048	2,066
Basic earnings per share	.28	.27	.25	.24
Diluted earnings per share	.26	.26	.24	.23
2005:				
Interest income	\$ 9,154	\$ 10,022	\$ 10,590	\$ 11,136
Net interest income	8,086	8,731	9,022	9,334
Provision for loan losses	519	(450)	(69)	600
Other operating income	1,218	1,346	1,506	1,650
Other operating expense	6,368	6,829	6,760	6,856
Income before taxes	2,417	3,698	3,837	3,528
Net income	1,692	2,323	2,418	2,255
Basic earnings per share	.20	.27	.28	.27
Diluted earnings per share	.19	.26	.27	.26

Table of Contents**(20) Parent Company Financial Information**

This information should be read in conjunction with the other notes to the consolidated financial statements. The following presents summary balance sheets and summary statements of operations and cash flows information for the years ended December 31:

Balance Sheets	2006	2005
Assets		
Cash	\$ 681	\$ 1,151
Investment in wholly owned subsidiary	61,309	55,651
Other assets	—	—
Total assets	\$ 61,990	\$ 56,802
Liabilities and stockholders' equity		
Stockholders' equity	61,990	56,802
Total liabilities and stockholders' equity	\$ 61,990	\$ 56,802

Statements of Operations	2006	2005	2004
Dividends from subsidiary	\$ 2,500	\$ 3,500	\$ 1,000
Other operating expenses	(94)	(97)	(68)
Income tax benefit	39	40	28
Income before undistributed earnings of subsidiary	2,445	3,443	960
Equity in undistributed earnings of subsidiary	6,365	5,245	5,747
Net income	\$ 8,810	\$ 8,688	\$ 6,707

Statements of Cash Flows	2006	2005	2004
Net income	\$ 8,810	\$ 8,688	\$ 6,707
Adjustments to reconcile net income to net cash provided by operating activities			
Decrease (increase) in other assets	—	11	(10)
Equity in undistributed earnings of subsidiary	(6,365)	(5,245)	(5,747)
Net cash provided by operating activities	2,445	3,454	950
Cash flows from financing activities:			
Common stock issued	1,288	948	758
Stock repurchases	(4,188)	(3,854)	(1,640)
Cash in lieu of fractional shares	(15)	(15)	(12)
Net cash used in financing activities	(2,915)	(2,921)	(894)
Net change in cash	(470)	533	56

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Cash at beginning of year		1,151		618		562
Cash at end of year	\$	681	\$	1,151	\$	618

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ITEM 9 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A - CONTROLS AND PROCEDURES

(a) Disclosure controls and procedures

The Company maintains “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to management, including the Company’s chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. The Company’s disclosure controls and procedures have been designed to meet and management believes that they meet reasonable assurance standards. Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, the chief executive officer and chief financial officer have concluded that the Company’s disclosure controls and procedures were effective to ensure that material information relating to the Company, including its consolidated subsidiary, is made known to them by others within those entities.

(b) Internal controls over financial reporting

The management of the Company is responsible for the preparation, integrity and fair presentation of its published financial statements and all other information presented in the Company’s consolidated financial statements. The Company’s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and, as such, include amounts based on informed judgments and estimates made by management.

Management maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with management’s authorization and recorded properly to permit the preparation of consolidated financial statements in accordance with US GAAP. Management recognizes that even a highly effective internal control system has inherent risks, including the possibility of human error and the circumvention or overriding of controls, and that the effectiveness of an internal control system can change with circumstances. Management has assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006. In making this assessment, management used the following criteria: criteria established in Internal Control - Integrated Framework issued by Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on Management’s assessment, they believe that, as of December 31, 2006, the Company’s internal control system over financial reporting is effective based on those criteria. “Management’s Report on Internal Control over Financial Reporting” is presented on page 44.

The Audit Committee of the Board of Directors is comprised entirely of directors who are independent of the Company’s Management. It includes an audit committee technical expert and members with banking or related financial management expertise and who are not large customers of the Bank. The Audit Committee has access to outside counsel. The Audit Committee is responsible for selecting the independent registered public accounting firm subject to ratification by the shareholders. It meets periodically with management, the independent registered public accounting firm, and the internal auditors to provide a reasonable basis for concluding that the Audit Committee is carrying out its responsibilities. The Audit Committee is also responsible for performing an oversight role by reviewing and monitoring Management’s financial, accounting, and auditing procedures in addition to reviewing

Management's financial reports. The independent registered public accounting firm and internal auditors have full and free access to the Audit Committee, with or without the presence of management; to discuss the adequacy of internal controls for financial reporting and any other matters which they believe should be brought to the attention of the Audit Committee.

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The Company's assessment of the effectiveness of internal control over financial reporting and the Company's consolidated financial statements have been audited by MOSS ADAMS LLP, an independent registered public accounting firm, which was given unrestricted access to all financial records and related data, including minutes of all meetings of shareholders, the Board of Directors and committees of the Board. Management believes that all representations made to the independent registered public accounting firm during their audit were valid and appropriate. The independent registered public accounting firm's report is presented on page 45.

During the quarter ended December 31, 2006, there were no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

ITEM 9B - OTHER INFORMATION

None.

PART III

ITEM 10 - DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE

The information called for by this item with respect to director and executive officer information is incorporated by reference herein from the sections of the Company's proxy statement for the 2007 Annual Meeting of Shareholders entitled "Executive Officers," "Security Ownership of Certain Beneficial Owners and Management," "Executive Compensation" "Report of Audit Committee," "Section 16(a) Beneficial Ownership Compliance" and "Nomination and Election of Directors."

The Company has adopted a Code of Conduct, which complies with the Code of Ethics requirements of the Securities and Exchange Commission. A copy of the Code of Conduct is posted on the "Investor Relations" page of the Company's website, or is available, without charge, upon the written request of any shareholder directed to Lynn Campbell, Corporate Secretary, First Northern Community Bancorp, 195 North First Street, Dixon, California 95620. The Company intends to disclose promptly any amendment to, or waiver from any provision of, the Code of Conduct applicable to senior financial officers, and any waiver from any provision of the Code of Conduct applicable to directors, on the "Investor Relations" page of its website.

The Company's website address is www.thatsmybank.com.

ITEM 11 - EXECUTIVE COMPENSATION

The information called for by this item is incorporated by reference herein from the sections of the Company's proxy statement for the 2007 Annual Meeting of Shareholders entitled "Compensation Committee Interlocks and Insider Participation," "Nomination and Election of Directors," "Compensation Discussion and Analysis," "Compensation Committee Report," "Transactions with Related Persons," "Director Compensation," and "Executive Compensation."

Table of Contents**ITEM 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information concerning ownership of the equity stock of the Company by certain beneficial owners and management is incorporated herein by reference from the sections of the Company's proxy statement for the 2007 Annual Meeting of Shareholders entitled "Security Ownership of Management" and "Nomination and Election of Directors."

Stock Purchase Equity Compensation Plan Information

The following table shows the Company's equity compensation plans approved by security holders. The table also indicates the number of securities to be issued upon exercise of outstanding options, weighted average exercise price of outstanding options and the number of securities remaining available for future issuance under the Company's equity compensation plans as of December 31, 2006. The plans included in this table are the Company's 2000 Stock Option Plan, the Company's Outside Director 2000 Non-statutory Stock Option Plan and the Company's 2006 Amended Employee Stock Purchase Plan. See "Stock Compensation Plans" Note 12 of Notes to Consolidated Financial Statements (page 68) included in this report.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	519,656	\$10.97	1,012,452
Equity compensation plans not approved by security holders	—	—	—
Total	519,656	\$10.97	1,012,452

ITEM 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information called for by this item is incorporated herein by reference from the sections of the Company's proxy statement for the 2007 Annual Meeting of Shareholders entitled "Director Independence" and "Transactions with Related Persons."

ITEM 14 - PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information called for by this item is incorporated herein by reference from the section of the Company's proxy statement for the 2007 Annual Meeting of Shareholders entitled "Audit and Non-Audit Fees."

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PART IV

ITEM 15 - EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements:

Reference is made to the Index to Financial Statements under Item 8 in Part II of this Form 10-K

(a)(2) Financial Statement Schedules:

All schedules to the Company's Consolidated Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Consolidated Financial Statements or accompanying notes.

(a)(3) Exhibits:

The following is a list of all exhibits filed as part of this Annual Report on Form 10-K

Exhibit Number	Exhibit
<u>3.1</u>	Amended Articles of Incorporation of the Company - provided herewith
3.3	Amended and Restated Bylaws of the Company - incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K on September 15, 2005
10.1	First Northern Community Bancorp 2000 Stock Option Plan - incorporated herein by reference to Exhibit 4.1 of Registrant's Registration Statement on Form S-8 on May 25, 2000 *
10.2	First Northern Community Bancorp Outside Directors 2000 Non-statutory Stock Option Plan - incorporated herein by reference to Exhibit 4.3 of Registrant's Registration Statement on Form S-8 on May 25, 2000 *
10.3	Amended First Northern Community Bancorp Employee Stock Purchase Plan - incorporated by reference to Appendix B of the Company's Definitive Proxy Statement on Schedule 14A for its 2006 Annual Meeting of Shareholders
10.4	First Northern Community Bancorp 2000 Stock Option Plan Forms "Incentive Stock Option Agreement" and "Notice of Exercise of Stock Option" - incorporated herein by reference to Exhibit 4.2 of Registration Statement on Form S-8 on May 25, 2000 *
10.5	First Northern Community Bancorp 2000 Outside Directors 2000 Non-statutory Stock Option Plan Forms "Non-statutory Stock Option Agreement" and "Notice of Exercise of Stock Option" - incorporated herein by reference to Exhibit 4.4 of Registrant's Registration Statement on Form S-8 May 25, 2000 *
10.6	First Northern Community Bancorp 2000 Employee Stock Purchase Plan Forms "Participation Agreement" and "Notice of Withdrawal" - incorporated herein by

reference to Exhibit 4.6 of Registration Statement on Form S-8 on May 25, 2000 *

- 10.7 Amended and Restated Employment Agreement entered into as of July 23, 2001 by and between First Northern Bank of Dixon and Don Fish - incorporated herein by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 *

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- 10.8 Employment Agreement entered into as of July 23, 2001 by and between First Northern Bank of Dixon and Owen J. Onsum - incorporated herein by reference to Exhibit 10.2 of Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 *
- 10.9 Employment Agreement entered into as of July 23, 2001 by and between First Northern Bank of Dixon and Louise Walker - incorporated herein by reference to Exhibit 10.3 of Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 *
- 10.10 Employment Agreement entered into as of July 23, 2001 by and between First Northern Bank of Dixon and Robert Walker - incorporated herein by reference to Exhibit 10.4 of Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 *
- 10.11 Form of Director Retirement and Split Dollar Agreements between First Northern Bank of Dixon and Lori J. Aldrete, Frank J. Andrews Jr., John M. Carbahal, Gregory DuPratt, John F. Hamel, Diane P. Hamlyn, Foy S. McNaughton, William Jones, Jr. and David Schulze - incorporated herein by reference to Exhibit 10.11 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001 *
- 10.12 Form of Salary Continuation and Split Dollar Agreement between First Northern Bank of Dixon and Owen J. Onsum, Louise A. Walker, Don Fish, and Robert Walker - incorporated herein by reference to Exhibit 10.12 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001 *
- 10.13 Amended Form of Director Retirement and Split Dollar Agreements between First Northern Bank of Dixon and Lori J. Aldrete, Frank J. Andrews Jr., John M. Carbahal, Gregory DuPratt, John F. Hamel, Diane P. Hamlyn, Foy S. McNaughton, William Jones, Jr. and David Schulze - by reference to Exhibit 10.13 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2005 *
- 10.14 Amended Form of Salary Continuation and Split Dollar Agreement between First Northern Bank of Dixon and Owen J. Onsum, Louise A. Walker, Don Fish, and Robert Walker - by reference to Exhibit 10.14 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2005 *
- 10.15 Form of Salary Continuation Agreement between Pat Day and First Northern Bank of Dixon - provided herewith*

<u>10.16</u>	Form of Supplemental Executive Retirement Plan Agreement between First Northern Bank of Dixon and Owen J. Onsum and Louise A. Walker - provided herewith*
10.17	First Northern Bancorp 2006 Stock Incentive Plan - incorporated by reference to Appendix A of the Company's Definitive Proxy Statement on Schedule 14A for its 2006 Annual Meeting of Shareholders *
<u>10.18</u>	First Northern Bank Annual Incentive Compensation Plan - provided herewith
11	Statement of Computation of Per Share Earnings (<i>See</i> Page 55 of this Form 10-K)
<u>21</u>	Subsidiaries of the Company - provided herewith
<u>23.1</u>	Consent of independent registered public accounting firm - provided herewith
<u>23.2</u>	Consent of independent registered public accounting firm - provided herewith
<u>31.1</u>	Rule 13(a) - 14(a) / 15(d) -14(a) Certification of the Company's Chief Executive Officer - provided herewith
<u>31.2</u>	Rule 13(a) - 14(a) / 15(d) -14(a) Certification of the Company's Chief Financial Officer - provided herewith
<u>32.1</u>	Section 1350 Certification of the Chief Executive Officer - provided herewith
<u>32.2</u>	Section 1350 Certification of the Chief Financial Officer - provided herewith

* Management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 15, 2007.

FIRST NORTHERN COMMUNITY BANCORP

By: /s/ Owen J. Onsum
 Owen J. Onsum
 President/Chief Executive Officer/Director
 (Principal Executive Officer)

By: /s/ Louise A. Walker
 Louise A. Walker
 Senior Executive Vice President/Chief
 Financial Officer
 (Principal Financial Officer)

By: /s/ Stanley R. Bean
 Stanley R. Bean
 Senior Vice President/Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Name</u>	<u>Title</u>	<u>Date</u>
/s/ LORI J. ALDRETE Lori J. Aldrete	Director	March 15, 2007
/s/ FRANK J. ANDREWS, JR. Frank J. Andrews, Jr.	Director and Chairman of the Board	March 15, 2007
/s/ JOHN M. CARBAHAL John M. Carbahal	Director	March 15, 2007
/s/ GREGORY DUPRATT Gregory DuPratt	Director and Vice Chairman of the Board	March 15, 2007
/s/ JOHN F. HAMEL John F. Hamel	Director	March 15, 2007
/s/ DIANE P. HAMLYN	Director	March 15, 2007

Diane P. Hamlyn

/s/ FOY S. MCNAUGHTON
Foy S. McNaughton

Director

March 15, 2007

/s/ DAVID W. SCHULZE

Director

March 15, 2007