Fresno First Bank

2013

ANNUAL REPORT

FRESNO FIRST BANK

Fresno First Bank strives to be the best company our employees ever work for, the best bank our customers ever do business with, and the best investment our shareholders ever make!

-FFB Employee/Owner

Message from the Chairman

In December 2005 we set out to create a bank committed to building client relationships and creating shareholder value. To this end we have made progress and continue to develop momentum as we look to the future.

Fresno First Bank has a strong foundation of dedicated employees who believe in our culture of shared employee ownership. Each employee is a vital part of the Fresno First Bank team. We all work together to build strong relationships with our clients which has been one of our goals since we opened our doors. Our strong foundation is what we are building on for the future, both short and long term.

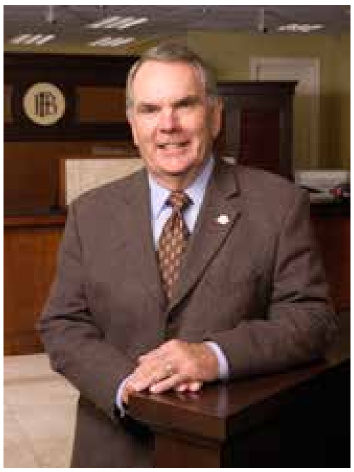
Looking forward to the next few years and beyond, we are excited to propose to our shareholders the formation of a holding company for Fresno First Bank to be called Communities First Financial Corp. If approved, our new holding company will provide operational opportunities we do not presently have. We will remain focused on meeting the banking needs of our clients, but look forward to offering services in addition to banking as appropriate opportunities present themselves. Our goal is that this new venture will also help us to continue our drive for increased shareholder value.

The support of our shareholders is vital and creating shareholder value is our number one priority. I want to take this opportunity to extend my personal thanks to each and every one of you for placing your continued trust in our institution.

David N. Price
Chairman of the Board

FRESNO FIRST BANK

Message from the President & CEO



One Step Back, Two Steps Forward

2013 was a challenging year with mixed results. Our unaudited net income was $26,000 for the year ended December 31, 2013 compared to income of $1,171,000 for 2012. Income for the 4th quarter ended December 31, 2013 rose to $509,000 compared to net income of $262,000 during the comparable quarter in 2012, a 94% increase. Fully diluted earnings per share were $.01 and $.49 in 2013 and 2012 respectively.

In 2013 our net income fell short of goal, but in other ways we had a very successful year and have better positioned the Bank for future success. In June we wrote off a significant loan relationship. To battle back from a million dollar loss at the end of the second quarter with two of our best quarters back to back, and to turn a profit for the year, took a real team effort. We saw significant gains in our top line revenue, an improved efficiency ratio and significant growth in loans, deposits and the number of customers we serve.

Looking forward, we are well positioned for success in 2014. To ensure we continue to grow the loan portfolio and offer a quick turnaround on loan requests, we have increased our credit department staff. Based on the Bank's vision and five year strategic plan, we have opened loan production offices in both Bakersfield and the Sacramento/Roseville markets. This will allow us to grow our loan volume, improve our loan to deposit ratio and improve our net interest income. We have also expanded our SBA operations to improve efficiencies and penetrate new markets.

In addition, to better serve the merchant processing market, we have been approved as an "Acquiring Bank". This new designation allows us to expand both our market presence and grow our non-interest income in the merchant processing market.

We look forward to an exciting year of growth and profitability!

Richard "Rick" Whitsell
President & CEO

FRESNO FIRST BANK

Mission Statement

The mission of Fresno First Bank is to become the Bank of choice for business owners, professionals, entrepreneurs and individuals that value a high touch approach, or "relationship" approach to their banking needs. We will accomplish this by:

- Developing an ownership culture that fosters a working environment which encourages professional and financial growth and entrepreneurial freedom.
- Committing to exceed customer service expectations for quality, responsiveness and professional excellence.
- Generating a superior return for our shareholders while investing in the communities we serve.

Values Statement

Fresno First Bank will be the Bank of choice for successful businesses and individuals who value superior service and a relationship approach to their banking and financing needs. Our group of experienced professional bankers will help clients navigate through complex financial choices which will ultimately assist in stimulating economic growth in our community. Our commitment to an ownership culture will foster an exceptional work environment that generates a fair return for our shareholders.

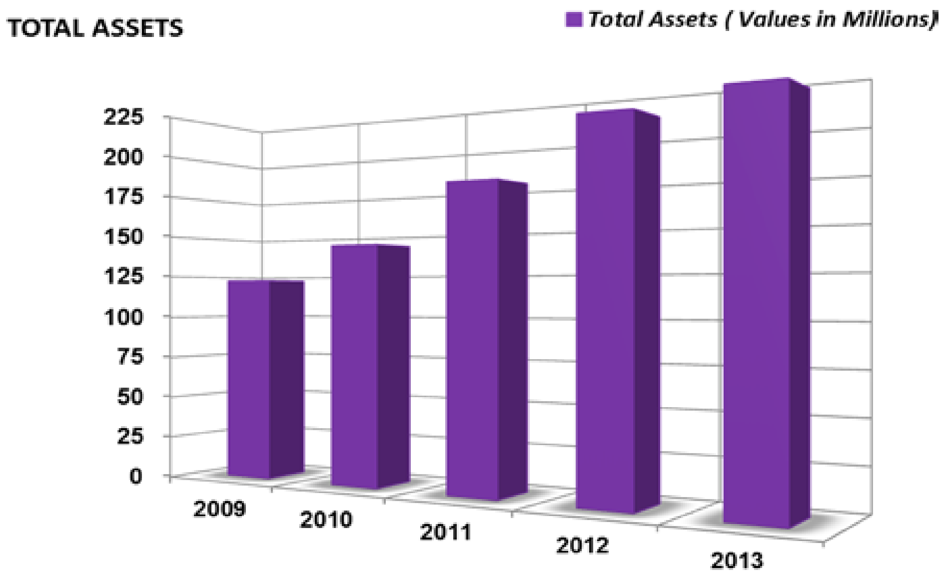
Core Values

We Value:

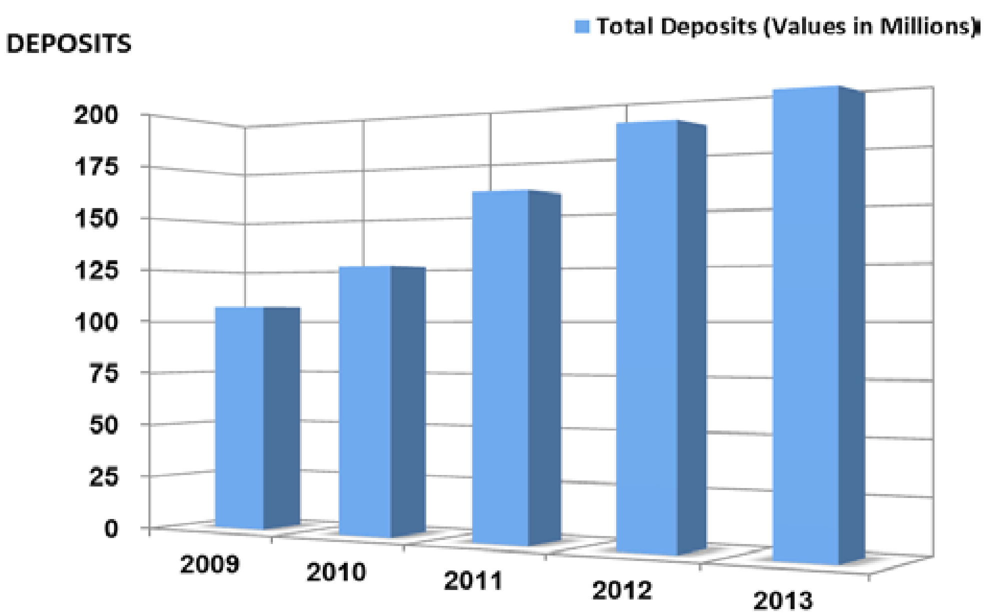
- The highest standard of ethical behavior and professional integrity.
- An owner-orientated working environment dedicated to teamwork that encourages respect and dignity, while recognizing and rewarding innovation and exceptional performance.
- Proactive, solutions-orientated recommendations that consistently exceed client expectations.
- The loyalty of our client relationships gained by knowing, understanding and placing their needs first.

FRESNO FIRST BANK

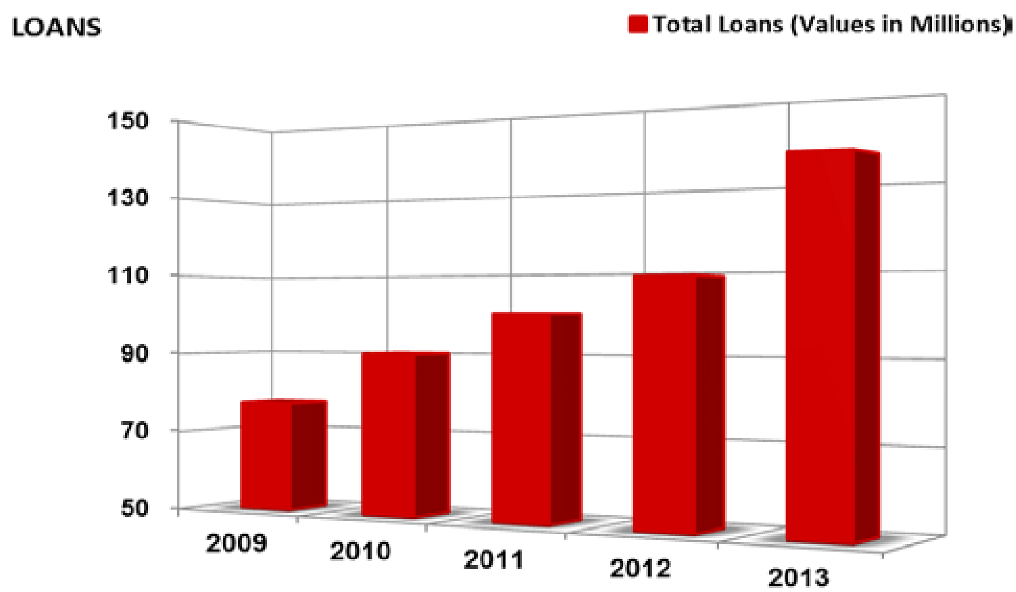
Over the last four years total assets have increased almost $100 million to $218.9 million at December 31, 2013. As our assets grow so does our ability to generate additional interest income which will increase earnings and shareholder value.



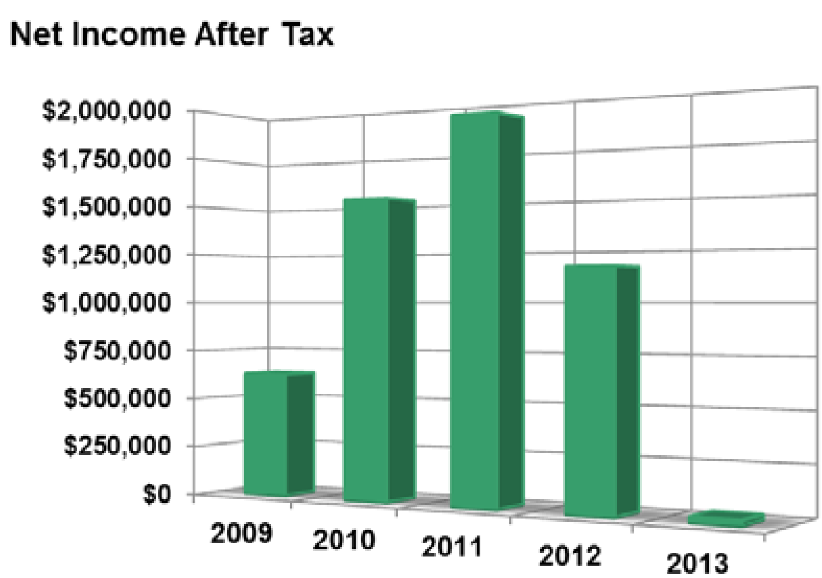
Low cost, local core deposits from customers who desire relationship banking provide the fuel to grow our loan portfolio and the Bank's profitability. Over the last four years our deposits have increased from $107 million to almost $197 million at December 31, 2013.



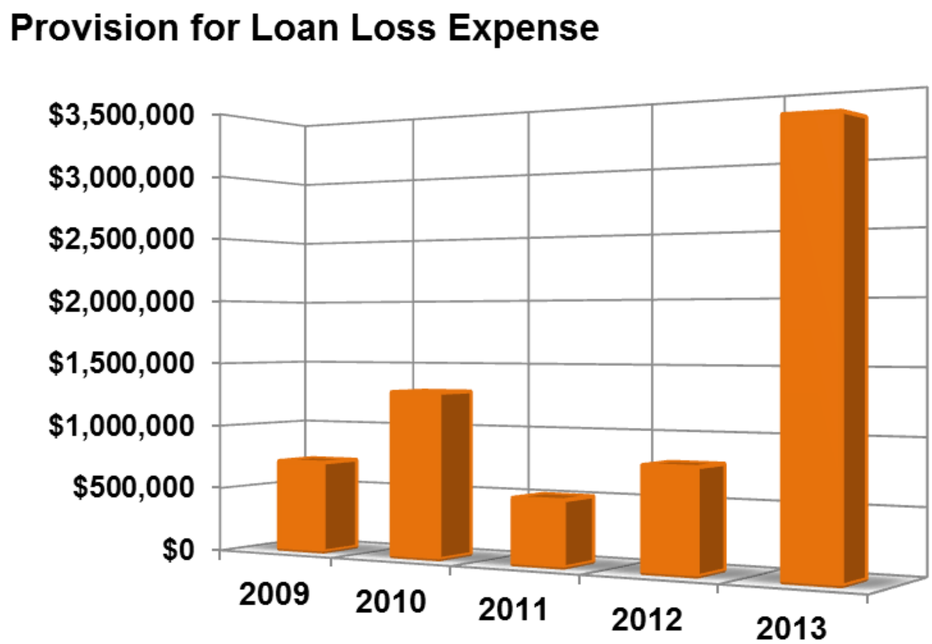
Historically we have outpaced our peer banks in loan growth and 2013 was no exception. For the year, we grew our total loans outstanding by $27 million reaching $136 million at year end, an increase of 25%. While we saw growth in all areas of our loan portfolio, in October our SBA department received the distinction of being named the most active Small Business Administration ("SBA") Community Bank Lender for the 2013 fiscal year.



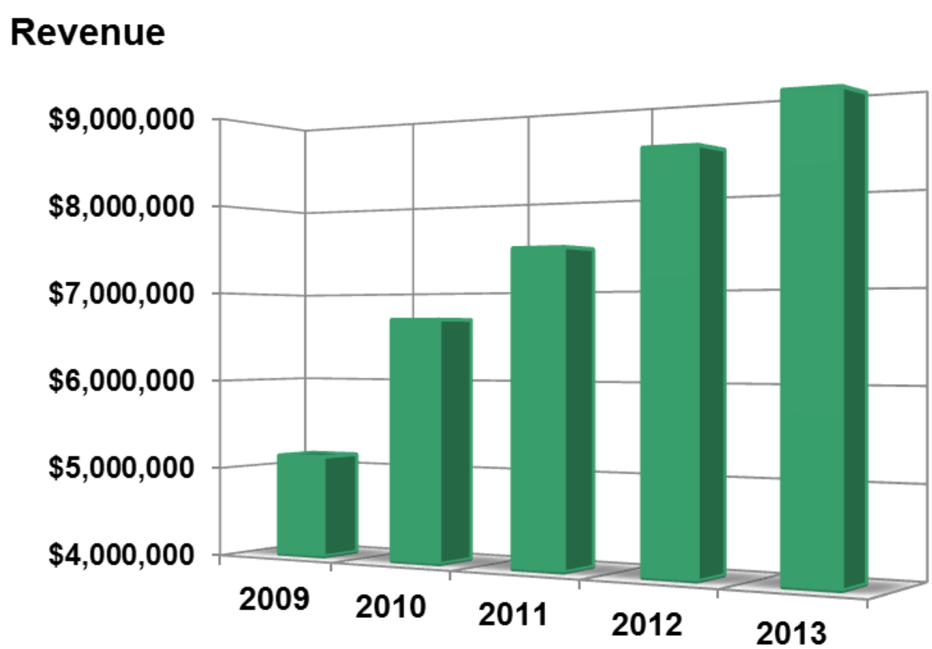
In 2009 we reached profitability and have now recorded five consecutive profitable years. In 2013 net income after tax was down as a result of an increase in the provision for loan loss Expense caused by mid-year loan charge offs and the growth of our loan portfolio.



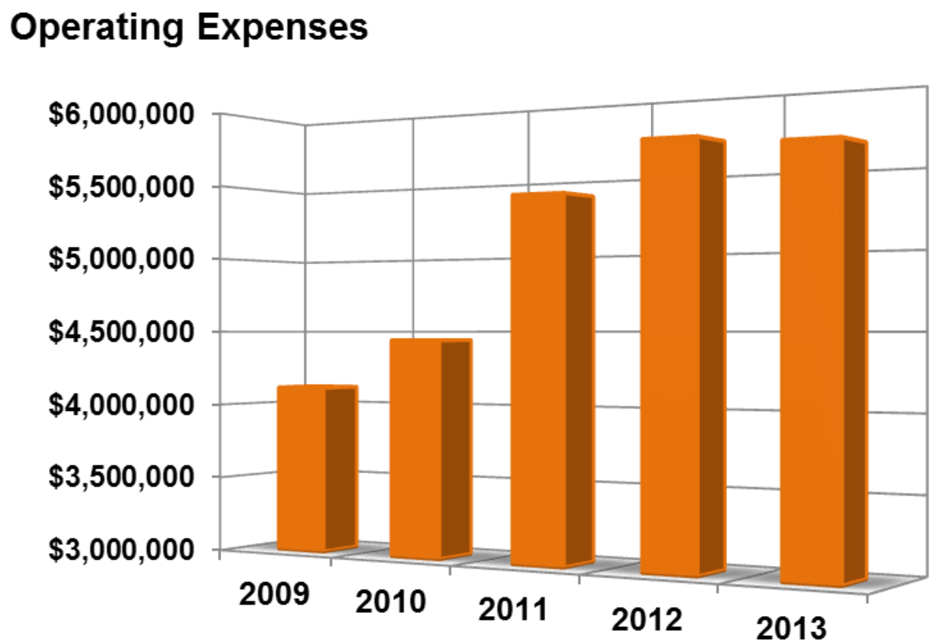
Below is a graphic display of just how significant the provision for loan loss expense was in 2013 compared to the prior four years.



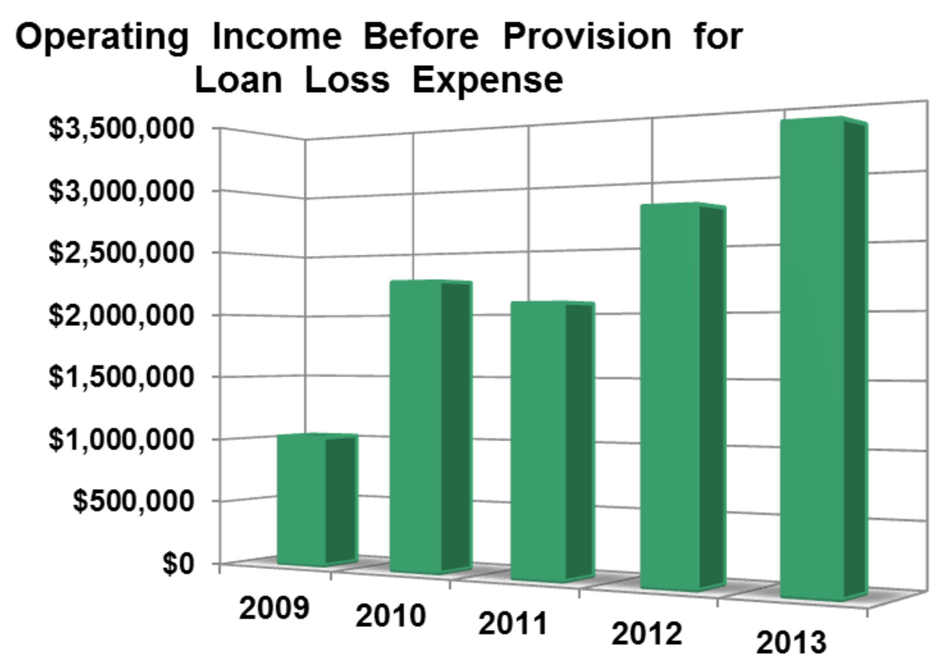
Although the overall income results were disappointing, there were a number of positive takeaways when you dig into our performance numbers. Gross Revenue from operations over the last four years has increased from $5.1 million to $9 million, a 76% increase.



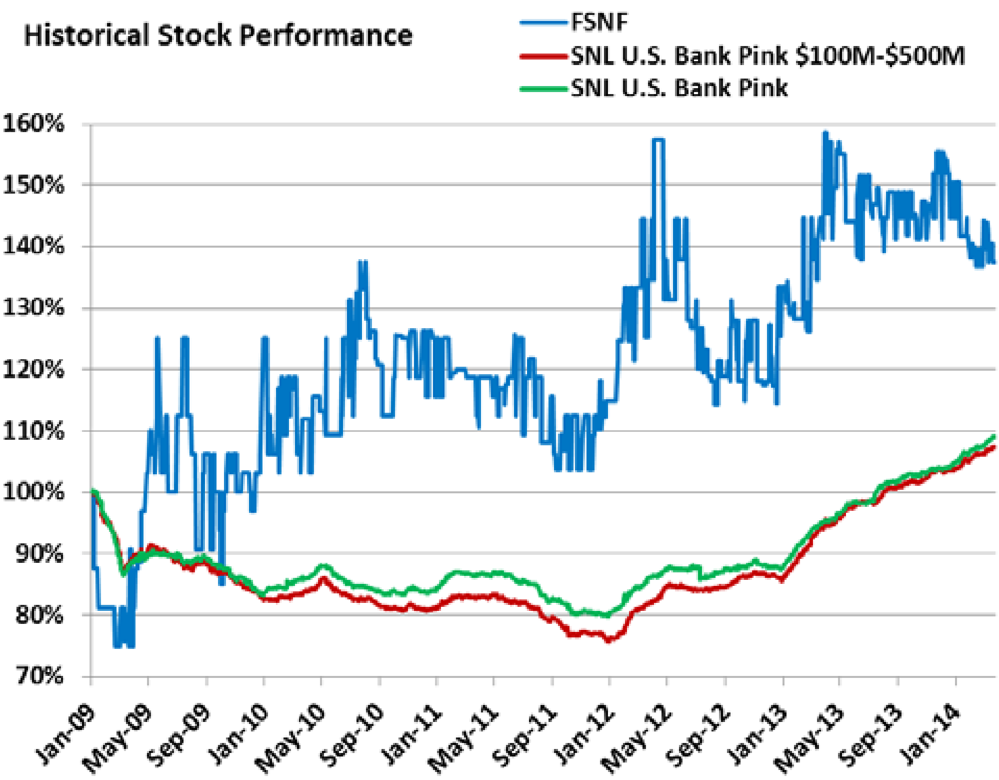
While generating an additional $3.8 million in revenue, over the same period our operating expenses have increased only $1.5 million, or 37%. Below is a graph of our non-interest operating expenses over the last five years.



Over the past four years we have seen operating revenue before the provision for loan losses increase from $1 million to over $3.3 million, a 225% increase. While occasionally all banks experience loan losses, this increase in operating income is a very positive trend in today's environment and should bode well for the future.



Over the last 5 years Fresno First Bank's stock has posted close to a 40% gain while banks of similar size have gained only 10%. The chart below illustrates the relative performance of Fresno First Bank's stock vs. a broad index of banks of similar size and market.



Report of Independent Auditors
and Financial Statements

Fresno First Bank

December 31, 2013 and 2012

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

Acumen. Agility. Answers.

Fresno First Bank

CONTENTS

FRESNO FIRST BANK

MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders
Fresno First Bank

Report on Financial Statements

We have audited the accompanying financial statements of Fresno First Bank, which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fresno First Bank as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Stockton, California
March 26, 2014

ASSETS

	DECEMBER 31, 2013	DECEMBER 31, 2012
Cash and due from banks	$ 6,805,854	$ 11,033,163
Federal funds sold	239,000	18,575,000
Interest bearing deposits in banks	2,750,000	3,250,000
Total cash and cash equivalents	9,794,854	32,858,163
Certificates of deposit	1,494,000	747,000
Securities available-for-sale	66,338,524	63,921,698
Loans held for sale	1,059,887	-
Loans, net	132,491,048	106,464,501
Correspondent bank stock, at cost	1,127,720	941,600
Premises and equipment	515,784	471,806
Other real estate owned	2,023,493	2,223,493
Interest receivable and other assets	4,087,926	2,653,934
	$ 218,933,236	$ 210,282,195

LIABILITIES AND SHAREHOLDERS' EQUITY

	2013	2012
Deposits	$ 197,026,864	$ 186,447,327
Interest payable and other liabilities	446,429	567,095
Total liabilities	197,473,293	187,014,422
Commitments and contingencies (Notes 4 and 11)		
Shareholders' equity:		
Preferred stock – 5,000,000 shares authorized, $100 par value Series C shares, 61,000 issued and outstanding in 2013 and 2012	5,715,038	5,715,038
Common stock – 5,000,000 shares authorized, no par value; 1,963,015 and 1,857,893 shares issued and outstanding in 2013 and 2012, respectively	19,483,509	18,384,665
Additional paid-in capital	1,629,111	1,626,381
Accumulated deficit	(4,350,739)	(3,092,670)
Accumulated other comprehensive (loss) income, net	(1,016,976)	634,359
Total shareholders' equity	21,459,943	23,267,773
Total liabilities and shareholders' equity	$ 218,933,236	$ 210,282,195

See accompanying notes

	YEARS ENDED DECEMBER 31, 2013	2012
INTEREST INCOME		
Interest and fees on loans	$ 7,017,926	$ 6,550,149
Interest on investment securities	1,398,932	1,136,171
Interest on federal funds sold and other	77,487	47,987
Total interest income	8,494,345	7,734,307
INTEREST EXPENSE		
Interest on savings deposits, NOW, and money market accounts	187,355	221,879
Interest on time deposits	279,799	347,834
Interest on other borrowings	26	11
Total interest expense	467,180	569,724
Net interest income	8,027,165	7,164,583
PROVISION FOR LOAN LOSSES	3,275,000	783,000
Net interest income after provision for loan losses	4,752,165	6,381,583
NON-INTEREST INCOME		
Service charges on deposits	469,675	452,056
Mortgage fee income	238,112	297,302
Gain on sale of investment securities	16,799	100,615
Gain on sale of loans held-for-sale	317,804	324,114
Gain on sale of other real estate owned	-	67,476
Other operating income	98,129	57,753
Total non-interest income	1,140,519	1,299,316
NON-INTEREST EXPENSES		
Salaries and employee benefits	3,117,771	3,261,374
Occupancy and equipment expenses	561,476	555,995
Regulatory assessments	146,877	139,497
Data processing fees	403,622	381,240
Professional fees	260,672	189,755
Marketing and business promotion	253,647	272,453
Director fees and stock-based compensation	201,199	211,799
Write-down of other real estate owned	200,000	-
Other expenses	703,329	686,098
	5,848,593	5,698,211
Income before income taxes	44,091	1,982,688
Provision for income taxes	18,000	812,000
Net income	$ 26,091	$ 1,170,688
Preferred stock dividends and accretion	$ 305,000	$ 105,772
Net (loss) income available to common shareholders	$ (278,909)	$ 1,064,916
Net (loss) income per share – basic	$ (0.15)	$ 0.57
Net (loss) income per share – diluted	$ (0.15)	$ 0.42

	YEARS ENDED DECEMBER 31, 2013	2012
Net income	$ 26,091	$ 1,170,688
Available-for-sale securities:		
Unrealized holding (losses) gains during the year	(2,782,095)	498,986
Reclassification adjustment for gains realized in net income	(16,799)	(100,615)
Net unrealized (losses) gains	(2,798,894)	398,371
Income tax benefit (expense)	1,147,559	(163,344)
Other comprehensive (loss) income	(1,651,335)	235,027
Total comprehensive (loss) income	$ (1,625,244)	$ 1,405,715

See accompanying notes

FRESNO FIRST BANK

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Preferred Stock		Common Stock		Additional	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Paid-in Capital	Deficit	Income (Loss)	Total
Balances, December 31, 2011	2,066	$ 2,063,278	1,766,010	$ 17,599,944	$ 1,563,586	$ (3,405,470)	$ 399,332	$ 18,220,670
Stock-based compensation	-	-	-	-	62,795	-	-	62,795
Exercise of stock options	-	-	3,674	34,944	-	-	-	34,944
Dividend paid on Series A and B preferred stocks	-	-	-	-	-	(103,050)	-	(103,050)
Accretion of Series A and B preferred stocks	-	2,722	-	-	-	(2,722)	-	-
Five percent stock dividend	-	-	88,209	749,777	-	(749,777)	-	-
Cash paid in lieu of fractional shares	-	-	-	-	-	(2,339)	-	(2,339)
Issuance of Series C preferred stock, net of stock offering costs of $384,962	61,000	5,715,038	-	-	-	-	-	5,715,038
Redemption of Series A and B preferred stocks	(2,066)	(2,066,000)	-	-	-	-		(2,066,000)
Net income	-	-	-	-	-	1,170,688	-	1,170,688
Other comprehensive income	-	-	-	-	-	-	235,027	235,027
Balances, December 31, 2012	61,000	5,715,038	1,857,893	18,384,665	1,626,381	(3,092,670)	634,359	23,267,773
Stock-based compensation	-	-	-	-	59,171	-	-	59,171
Exercise of stock options	-	-	12,058	121,672	(56,441)	-	-	65,231
Dividend paid on Series C preferred stocks	-	-	-	-	-	(305,000)	-	(305,000)
Five percent common stock dividend	-	-	93,064	977,172	-	(977,172)	-	-
Cash paid in lieu of fractional shares	-	-	-	-	-	(1,988)	-	(1,988)
Net income	-	-	-	-	-	26,091	-	26,091
Other comprehensive loss	-	-	-	-	-	-	(1,651,335)	(1,651,335)
Balances, December 31, 2013	61,000	$ 5,715,038	1,963,015	$ 19,483,509	$ 1,629,111	$ (4,350,739)	$ (1,016,976)	$ 21,459,943

See accompanying notes

	YEARS ENDED DECEMBER 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 26,091	$ 1,170,688
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization of premises and equipment	200,371	203,900
Amortization and accretion of premiums and discounts on securities available-for-sale, net	454,425	391,446
Provision for loan losses	3,275,000	783,000
Gain on sale of investment securities	(16,799)	(100,615)
Gain on sale of loans held-for-sale	(317,804)	(324,114)
Gain on sale of other real estate owned	-	(67,476)
Proceeds from sale of loans held-for-sale	12,594,198	12,555,757
Originations of loans held-for-sale	(13,336,281)	(12,231,643)
Stock-based compensation	59,171	62,795
Write-down of other real estate owned	200,000	-
(Increase) decrease in deferred taxes	(11,000)	256,000
Decrease in interest payable and other liabilities	(120,666)	(133,989)
Increase in interest receivable and other assets	(275,433)	(180,347)
Net cash from operating activities	2,731,273	2,385,402
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of certificates of deposit	(997,000)	(747,000)
Proceeds from maturities of interest bearing deposits	250,000	-
Purchase of available-for-sale securities	(24,455,422)	(48,177,128)
Proceeds from maturities of available-for-sale securities	17,352,488	39,241,916
Proceeds from sale of available-for-sale securities	1,449,588	1,530,185
Net increase in loans	(29,301,547)	(12,392,460)
Purchase of correspondent bank stock	(186,120)	(160,300)
Proceeds from sale of other real estate owned	-	337,463
Purchases of premises and equipment	(244,349)	(75,269)
Net cash from investing activities	(36,132,362)	(20,442,593)

	YEARS ENDED DECEMBER 31,	
	2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits and savings accounts	14,866,068	33,271,619
Net decrease in time deposits	(4,286,531)	(5,598,630)
Net proceeds from issuance of Series C preferred stock	-	5,715,038
Redemption of Series A and B preferred stocks	-	(2,066,000)
Cash paid in lieu of fractional shares	(1,988)	(2,339)
Payment of dividends on Series A and B preferred stocks	-	(103,050)
Payment of dividends on Series C preferred stocks	(305,000)	-
Common stock issued	65,231	34,944
Net cash from financing activities	10,337,780	31,251,582
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(23,063,309)	13,194,391
CASH AND CASH EQUIVALENTS, beginning of period	32,858,163	19,663,772
CASH AND CASH EQUIVALENTS, end of period	$ 9,794,854	$ 32,858,163
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	$ 465,908	$ 573,320
Taxes paid	$ 210,000	$ 529,000
NON-CASH INVESTING ACTIVITIES:		
Transfer of loans to other real estate owned	$ -	$ 2,493,480

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Fresno First Bank (the Bank) conform to generally accepted accounting principles and general practices within the banking industry. A summary of the significant accounting policies applied in the preparation of the accompanying financial statements follows.

Nature of operations – The Bank is incorporated in the state of California and organized as a single operating segment that operates one full-service office in Fresno, California. The Bank's primary source of revenue is providing loans to customers, who are predominately small and middle-market businesses and individuals.

Estimates – In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reported period. Actual results could differ from those estimates.

The allowance for loan losses is the most significant accounting estimate reflected in the Bank's financial statements. The allowance for loan losses includes charges to reduce the recorded balances of loans receivable to their estimated net realizable value, as appropriate. The allowance is based on estimates, and ultimate losses may vary from current estimates. These estimates for losses are based on individual assets and their related cash flow forecasts, sales values, independent appraisals, the volatility of certain real estate markets, and concern for disposing of real estate in distressed markets. Although management of the Bank believes the estimates underlying the calculation of specific allowances are reasonable, there can be no assurances that the Bank could ultimately realize these values. In addition to providing valuation allowances on specific assets where a decline in value has been estimated, the Bank establishes general valuation allowances for losses based on the overall portfolio composition, general market conditions, concentrations, and prior loss experience of the Bank and its peers.

Other significant management judgments and accounting estimates reflected in the Bank's financial statements include:

- Decisions regarding the timing and placement of loans on non-accrual;
- Determination, recognition, and measurement of impaired loans;
- Recognition and measurement of asset servicing rights;
- Determination and evaluation of deferred tax assets and liabilities;
- Determination of the fair value of other real estate owned;
- Determination of the fair value of stock option awards; and
- Determination of the fair value of financial instruments.

Concentrations of credit risk – Assets and liabilities that subject the Bank to concentrations of credit risk consist of cash balances at other banks, loans, and deposits. Most of the Bank's customers are located within Fresno county and the surrounding areas. The Bank's primary lending products are discussed in Note 3 to the financial statements. The Bank did not have any significant concentrations in its business with any one customer or industry. The Bank obtains what it believes to be sufficient collateral to secure potential losses on loans. The extent and value of collateral varies based on the details underlying each loan agreement.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Concentrations of credit risk (continued) – As of December 31, 2013 and 2012, the Bank has cash deposits at other financial institutions in excess of FDIC insured limits. However, as the Bank places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal. Banking regulations require that banks maintain a percentage of their deposits as reserves in cash or on deposit with the Federal Reserve Bank. The Bank complied with the reserve requirements as of December 31, 2013 and 2012.

Cash and cash equivalents – For purposes of reporting cash flows, cash equivalents include cash, due from banks, interest-bearing deposits in financial institutions with maturities of 90 days or less, and federal funds sold. Generally, federal funds are sold for one-day periods and interest-bearing deposits are for periods of 90 days or less.

Securities available-for-sale – Available-for-sale 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 not classified as trading securities or held-to-maturity securities. These securities are carried at estimated fair value with unrealized holding gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income, until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. The amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the interest method over the period to call or maturity.

Investments with fair values that are less than amortized cost are considered impaired. Impairment may result from either a decline in the financial condition of the issuing entity or, in the case of fixed interest rate investments, from rising interest rates. At each financial statement date, management assesses each investment to determine if impaired investments are temporarily impaired or if the impairment is other than temporary. This assessment includes a determination of whether the Bank intends to sell the security, or if it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other than temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the amount of impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors.

The credit loss component is recognized in earnings and is calculated as the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of the future expected cash flows is deemed to be due to factors that are not credit related and is recognized in other comprehensive income.

Loans – Loans are reported at the principal amount outstanding, net of deferred loan fees and costs and the allowance for loan losses. Unearned discounts on installment loans are recognized as income over the terms of the loans. 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, are deferred and amortized over the contractual term of the loan as an adjustment to the interest yield. During the years ended December 31, 2013 and 2012, salaries and employee benefits expense totaling $92,033 and $51,954, respectively, were deferred as loan origination costs.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans (continued) – 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 90 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. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. 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.

Allowance for loan losses – The allowance for loan losses is established through a provision for loan losses charged to operations. Loan losses are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries of previously charged off amounts, if any, are credited to the allowance.

Management employs a systematic methodology for determining the allowance for loan losses. On a regular basis, management reviews the credit quality of the loan portfolio and considers problem and delinquent loans, existing general economic conditions affecting the key lending areas of the Bank, credit quality trends, collateral values, loan volumes and concentrations, seasoning of the loan portfolio, specific industry conditions, recent loss experience, duration of the current business cycle, bank regulatory examination results, and findings of the Bank's internal credit examiners. The allowance for loan losses at December 31, 2013 and 2012 reflects management's estimate of probable losses in the portfolio. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. Impaired loans, as defined, are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The general component relates to non-impaired loans and is based on historical loss experience and loss history experienced by the Bank's peers when the Bank did not have losses in a particular loan class, adjusted for qualitative factors impacting the loan portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The Bank considers a loan impaired when it is probable that all amounts of principal and interest due will not be collected according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, borrower's ability to repay, credit worthiness, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, current credit worthiness, and the amount of the shortfall in relation to the principal and interest owed.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Troubled debt restructuring – In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank grants a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring. The Bank measures any loss on the troubled debt restructuring in accordance with the guidance concerning impaired loans set forth above. Additionally, loans modified in troubled debt restructurings are generally placed on non-accrual status at the time of restructuring. These loans are returned to accrual status after the borrower demonstrates performance with the modified terms for a sustained period of time (generally six months) and has the capacity to continue to perform in accordance with the modified terms of the restructured debt.

Correspondent bank stock – The Bank is a member of the Federal Home Loan Bank (FHLB) system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. The Bank held stock in the FHLB totaling $912,100 and $941,600 at December 31, 2013 and 2012, respectively. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income. FHLB stock was not considered impaired as of December 31, 2013 and 2012. The remaining balance in the correspondent bank stock account on the balance sheet includes The Independent Bankers Bank (TIB) stock of $215,620 and $0 at December 31, 2013 and 2012, respectively. TIB stock is carried at cost and was not considered impaired as of December 31, 2013 and 2012.

Premises and equipment – Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which range from three to seven years for computer equipment, equipment, and furniture. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the improvements or the remaining lease term, whichever is shorter. Expenditures for betterments or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

Advertising costs – The Bank expenses the costs of advertising in the period incurred. Advertising expense was $162,323 and $170,121 for the years ended December 31, 2013 and 2012, respectively.

Other real estate owned – Real estate acquired by foreclosure or deed in lieu of foreclosure is recorded at fair value at the date of foreclosure, establishing a new cost basis by a charge to the allowance for loan losses, if necessary. Fair value is based on current appraisals less estimated selling costs. Any subsequent write-downs are charged against operating expenses and recognized as a valuation allowance. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other operating expenses. The Bank recorded a write down of $200,000 and $0 for other real estate owned during 2013 and 2012, respectively. There were no foreclosures or sales of other real estate owned in 2013. During 2012, the Bank foreclosed on two loans and transferred $2,493,480 to other real estate owned. The Bank sold one property with proceeds of $337,463 and recognized gain on sale of $67,476 in 2012.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans held for sale – Loans held for sale include mortgage loans and are reported at the lower of cost or market value. Cost generally approximates market value, given the short duration of these assets. Gains or losses on the sale of loans that are held for sale are recognized at the time of the sale, subject to the expiration of any warranty or recourse provisions, and determined by the difference between net sale proceeds and the net book value of the loans, plus the estimated fair value of any retained mortgage servicing rights, less the estimated discount associated with the unguaranteed portion of the sold loan that is retained. There were $1,059,887 and $0 of loans held for sale at December 31, 2013 or 2012, respectively.

Income taxes – The Bank uses the asset and liability method to account for income taxes. Under such method, deferred tax assets and liabilities are recognized for the future tax consequences of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis (temporary differences). Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes in the period of enactment.

A valuation allowance against net deferred tax assets is established to the extent that it is more likely than not that the benefits associated with the deferred tax assets will not be fully realized.

In accordance with accounting standards, the Bank has assessed its tax positions and has concluded there are no unrecognized tax benefits at December 31, 2013 and 2012.

The Bank recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2013 and 2012, the Bank recognized no interest and penalties.

The Bank files income tax returns in the U.S. federal jurisdiction and with the state of California. The Bank is subject to U.S. federal and state income tax examinations by tax authorities for years beginning 2009.

Comprehensive income – Changes in unrealized gains and losses on available-for-sale securities are the only component of accumulated other comprehensive income for the Bank.

Fair value measurement – Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Current accounting guidance establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices (unadjusted) for identical assets or liabilities in active markets, that the entity has the ability to access as of the measurement date.
Level 2	Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
Level 3	Significant unobservable inputs that reflect a Bank's own assumptions about the assumptions that market participants would use in pricing an asset or a liability.

See Note 14 for more information and disclosures relating to the Bank's fair value measurements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments – In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 15. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Earnings (loss) per share (EPS) – Basic EPS excludes 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 that could occur if securities or other contracts to issue common stock, such as stock options, were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The treasury stock method is applied to determine the dilutive effect of stock options when computing diluted earnings per share.

Stock-based compensation – The Bank recognizes the cost of employee services received in exchange for awards of stock options, or other equity instruments, based on the grant-date fair value of those awards. This cost is recognized over the period that an employee is required to provide services in exchange for the award, generally the vesting period. See Note 12 for additional information on the Bank's stock option plan.

Transfers of financial assets – Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Servicing rights – The Bank sells or transfers loans, including the guaranteed portion of various government agencies' loans (with servicing retained) for cash proceeds equal to the principal amount of loans, as adjusted to yield interest to the investor based upon the current market rates. The Bank records an asset representing the right to service a loan for others when it sells a loan and retains the servicing rights. The carrying value of the loan is allocated between the loan and the servicing rights, based on their relative fair values. The fair value of servicing rights is estimated by discounting estimated future cash flows from servicing using discount rates that approximate current market rates and estimated prepayment rates.

The servicing rights are initially measured at fair value and amortized in proportion to and over the period of the estimated net servicing income assuming prepayments. Additionally, management assesses the servicing rights for impairment as of each financial reporting date. For purposes of evaluating and measuring impairment, servicing rights are based on a discounted cash flow methodology, current prepayment speeds, and market discount rates. Any impairment is measured as the amount by which the carrying value of servicing rights for a stratum exceeds its fair value. The carrying value of servicing rights at December 31, 2013 and 2012 were $37,863 and $44,087, respectively. No impairment charges were recorded for the years ended December 31, 2013 or 2012 related to servicing assets.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Adoption of new accounting standards – In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income.* The ASU requires entities to provide enhanced disclosures to present separately by component, reclassifications out of accumulated other comprehensive income. An entity is required to disclose in the notes to the financial statements or parenthetically on the face of the financial statements, the effect of significant items reclassified out of accumulated other comprehensive income on the respective line items of net income, but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety. ASU No. 2013-02 is effective for fiscal years beginning on or after December 15, 2012. The Bank does not expect this ASU to have an impact on its financial condition or results of operations as it affects presentation only. Our adoption of this ASU in 2013 did not have a significant impact on the Bank's financial statements.

In January 2014, the FASB issued ASU No. 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure*, a consensus of the FASB Emerging Issues Task Force. The amendments in this update clarify that when an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both: (1) the amount of foreclosed residential real estate property held by the creditor, and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Bank does not expect this ASU to have an impact on its financial condition or results of operations as it affects presentation only.

NOTE 2 – INVESTMENT SECURITIES

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

2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 32,327,985	$ 477,873	$ (1,114,197)	$ 31,691,661
Mortgage-backed securities	16,483,121	94,569	(401,740)	16,175,950
State and municipal agencies	15,225,605	13,463	(885,890)	14,353,178
Corporate debt securities	4,025,501	92,234	-	4,117,735
	$ 68,062,212	$ 678,139	$ (2,401,827)	$ 66,338,524

2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale:				
U.S. government and agency securities	$ 34,959,031	$ 772,279	$ (5,401)	$ 35,725,909
Mortgage-backed securities	12,858,751	292,015	(39,061)	13,111,705
State and municipal agencies	11,041,561	127,097	(107,324)	11,061,334
Corporate debt securities	3,987,149	39,243	(3,642)	4,022,750
	$ 62,846,492	$ 1,230,634	$ (155,428)	$ 63,921,698

The amortized cost and estimated fair value of all investment securities as of December 31, 2013 by expected maturities are shown below. 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.

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 142,940	$ 143,049
Due after one year to five years	7,839,150	7,959,367
Due from five years to ten years	19,473,536	18,981,870
Due after ten years	40,606,586	39,254,238
	$ 68,062,212	$ 66,338,524

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

The gross unrealized loss and related estimated fair value of investment securities that have been in a continuous loss position for less than twelve months and over twelve months are as follows:

	2013					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 17,865,678	$ (1,102,158)	$ 1,757,076	$ (12,039)	$ 19,622,754	$ (1,114,197)
Mortgage-backed securities	10,205,515	(264,012)	2,229,838	(137,728)	12,435,353	(401,740)
State and municipal agencies	9,828,975	(647,619)	3,431,212	(238,271)	13,260,187	(885,890)
	$ 37,900,168	$ (2,013,789)	$ 7,418,126	$ (388,038)	$ 45,318,294	$ (2,401,827)

	2012					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government and agency securities	$ 2,127,899	$ (2,568)	$ 2,232,125	$ (2,833)	$ 4,360,024	$ (5,401)
Mortgage-backed securities	3,411,626	(39,061)	-	-	3,411,626	(39,061)
State and municipal agencies	6,207,056	(107,324)	-	-	6,207,056	(107,324)
Corporate debt securities	-	-	492,570	(3,642)	492,570	(3,642)
	$ 11,746,581	$ (148,953)	$ 2,724,695	$ (6,475)	$ 14,471,276	$ (155,428)

Certain investment securities shown in the previous table currently have fair values less than amortized cost and therefore contain unrealized losses. The Bank considers a number of factors including, but not limited to: (a) the length of time and the extent to which the fair value has been less than the amortized cost, (b) the financial condition and near-term prospects of the issuer, (c) the intent and ability of the Bank to retain its investment for a period of time sufficient to allow for an anticipated recovery in value, (d) whether the debtor is current on interest and principal payments, and (e) general market conditions and the industry-or sector-specific outlook. Management has evaluated all securities at December 31, 2013 and 2012 and has determined that no securities are other than temporarily impaired.

NOTE 2 – INVESTMENT SECURITIES (CONTINUED)

The Bank does not have the intent to sell the investments that are impaired, and it is more likely than not that the Bank will not be required to sell those investments before recovery of the amortized cost basis. The Bank has evaluated these securities and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any issuer or industry-specific event. These temporary unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. At December 31, 2013, there were 65 investment securities with unrealized losses. The Bank anticipates full recovery of amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment.

Proceeds from the sales of investment securities totaled $1,449,588 and $1,530,185 during the years ended December 31, 2013 and 2012, respectively. Gross realized gains totaled $25,052 and $100,615 during 2013 and 2012, respectively. Gross realized losses totaled $8,253 during 2013. There were no realized losses during 2012.

Investment securities carried at approximately $5,588,000 and $1,242,000 at December 31, 2013 and 2012, respectively, were pledged to secure public deposits or other purposes as permitted or required by law.

NOTE 3 – LOANS

Major classifications of loans are as follows:

	DECEMBER 31,	
	2013	2012
Commercial and industrial	$ 47,763,877	$ 35,442,291
Commercial real estate	43,579,467	40,838,323
Land and construction	7,390,927	6,482,128
Residential real estate	16,735,830	15,288,968
Agriculture	19,202,344	10,636,805
Consumer	209,808	157,366
	134,882,253	108,845,881
Allowance for loan losses	(2,523,337)	(2,498,139)
Deferred loan fees and costs, net	132,132	116,759
	$ 132,491,048	$ 106,464,501

NOTE 3 – LOANS (CONTINUED)

The Bank's loan portfolio consists primarily of loans to borrowers within Fresno county, California. Although the Bank seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, real estate and real estate associated businesses are among the principal industries in the Bank's market area.

All of the Bank's loans are underwritten by evaluating the borrower's character, cash flow, collateral, and credit worthiness and, for commercial and business loans, managerial and operational experience. Underwriting standards are designed to promote relationship banking rather than transactional banking.

Commercial and industrial loans are primarily made to commercial and business entities for working capital, equipment purchases, growth and expansion, and any other permissible purposes. The Bank's management examines current and projected cash flows to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as equipment, accounts receivable, or inventory and may incorporate personal guarantees or personal assets as collateral; however, some loans may be made on an unsecured basis.

Commercial real estate loans are primarily made to owner-users of the property or investors with current tenants in the property. Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Bank's commercial real estate portfolio are diverse in terms of type and industries operating within the properties. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral type, geography, industry, and risk grade criteria.

Land and construction loans are primarily made to borrowers who are using the property for their own purposes. The Bank does not make speculative land loans where repayment will be from the eventual sale of the property to unknown parties. Land loans are made with amortizing repayment terms to borrowers with proven, historic cash flow sufficient to repay the loan. Collateral values are based on the current "as is" market value of the property. Construction loans are made based on the borrower's historic and projected cash flow. The Bank does not engage in speculative construction loans where repayment will come from the sale or lease of the property to unknown parties.

NOTE 3 – LOANS (CONTINUED)

Residential real estate loans are made to individuals for the purchase or refinance of residential 1-to-4 family properties or for other consumer purposes. Residential real estate loans are underwritten based upon income, credit history, and collateral. To monitor and manage residential loan risk, policies and procedures are developed and modified, as needed. Underwriting standards for home loans are heavily influenced by statutory requirements, which include, but are not limited to, a determination and verification of the borrower's ability to repay the loan, maximum loan-to-value percentage, collection remedies, and documentation requirements.

Agricultural loans are primarily made to producers of agricultural products. Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate and/or agricultural commodities. Agricultural real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Agricultural crop loans may be more adversely affected by conditions in the weather or in the general economy. The properties securing the Bank's agricultural portfolio are diverse in terms of type of crop. This diversity helps reduce the Bank's exposure to adverse economic events that affect any single commodity. Management monitors and evaluates agricultural real estate loans based on collateral, crop type, geography, and risk grade criteria.

Consumer loans are made to individuals for personal, household, and family expenditures and consist of term loans and lines of credit. The Bank does not offer credit card plans. Consumer loans are subject to underwriting standards and processes similar to residential real estate loans and are based primarily on income, credit history, and collateral; however, some consumer loans are unsecured. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed. This activity coupled with relatively small loan amounts that are spread across many individual borrowers minimizes risk.

The Bank utilizes an independent third party loan review consultant to review and validate the credit risk program on a periodic basis. Results of these reviews are presented to management and the Bank's Board of Directors. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

NOTE 3 – LOANS (CONTINUED)

Information related to impaired loans as of December 31, 2013 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 124,723	$ -	$ -	$ 124,723
With a specific allowance recorded	-	845,109	-	-	-	-	845,109
Total recorded investment in impaired loans	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -	$ 969,832
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 124,723	$ -	$ -	$ 124,723
With a specific allowance recorded	-	845,109	-	-	-	-	845,109
Total unpaid principal balance of impaired loans	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -	$ 969,832
Specific allowance	$ -	$ 25,658	$ -	$ -	$ -	$ -	$ 25,658
Average recorded investment in impaired loans during the year	$ 330,006	$ 958,722	$ -	$ 113,634	$ -	$ -	$ 1,402,362
Interest income recognized on impaired loans during the year	$ -	$ 23,322	$ -	$ 10,308	$ -	$ -	$ 33,630

Information related to impaired loans as of December 31, 2012 and for the year ended consisted of the following:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Total
Recorded investment in impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 74,746	$ -	$ -	$ 74,746
With a specific allowance recorded	1,309,585	1,080,545	-	-	-	-	2,390,130
Total recorded investment in impaired loans	$ 1,309,585	$ 1,080,545	$ -	$ 74,746	$ -	$ -	$ 2,464,876
Unpaid principal balance of impaired loans:							
With no specific allowance recorded	$ -	$ -	$ -	$ 74,746	$ -	$ -	$ 74,746
With a specific allowance recorded	1,309,585	1,080,545	-	-	-	-	2,390,130
Total unpaid principal balance of impaired loans	$ 1,309,585	$ 1,080,545	$ -	$ 74,746	$ -	$ -	$ 2,464,876
Specific allowance	$ 523,834	$ 36,051	$ -	$ -	$ -	$ -	$ 559,885
Average recorded investment in impaired loans during the year	$ 454,846	$ 1,355,294	$ 1,933,508	$ 155,046	$ -	$ -	$ 3,898,694
Interest income recognized on impaired loans during the year	$ 95,545	$ 34,351	$ 71,536	$ 11,051	$ -	$ -	$ 212,483

NOTE 3 – LOANS (CONTINUED)

The Bank has established a loan risk rating system to measure and monitor the quality of the loan portfolio. All loans are assigned a risk rating from the inception of the loan until the loan is paid off. The primary loan grades are as follows:

Loans rated Pass – These are loans to borrowers with satisfactory financial support, repayment capacity, and credit strength. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank's policy regarding debt service coverage ratios. These borrowers are capable of sustaining normal economic, market, or operational setbacks without significant financial impacts. Financial ratios and trends are acceptable. Negative external industry factors are generally not present. The loan may be secured, unsecured, or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. These loans carry a normal degree of risk. The borrowers have the capacity to perform according to terms; any deviation from historic performance is limited and temporary.

Loans rated Special Mention – These are loans that have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special Mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. These loans exhibit a more weakened condition than Pass loans, but not to the degree where they would be considered substandard. These loans show definite signs of deterioration or weakness, and the likelihood of correction is somewhat questionable. Weaknesses might include significant earnings decline, collection of accounts receivable is slowing, delayed accounts payable, greater dependency on-line usage, and covenants not being met and/or waived for short periods.

Loans rated Substandard – These are loans that are inadequately protected by the current sound worth and paying capacity of the borrower or by the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans rated Doubtful – These are loans that have all the weaknesses inherent in a loan classified as Substandard with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable, and improbable. These loans have a high probability of loss due to significant deterioration in financial condition of the borrower and collateral value pledged, if any. The borrower is unable to demonstrate the ability to strengthen their financial condition within a reasonable time; therefore, close supervision is required and the loan is placed on non-accrual. The risk of loss is measured by an impairment analysis; any loss exposure determined through this analysis is to be charged off.

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2013:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial and industrial	$ 47,541,839	$ -	$ 222,038	$ -	$ 47,763,877
Commercial real estate	39,760,308	-	3,819,159	-	43,579,467
Land and construction	7,390,927	-	-	-	7,390,927
Residential real estate	16,392,527	-	343,303	-	16,735,830
Agriculture	19,202,344	-	-	-	19,202,344
Consumer	209,808	-	-	-	209,808
	$ 130,497,753	$ -	$ 4,384,500	$ -	$ 134,882,253

The following table summarizes the loan portfolio by credit quality and product and/or collateral type as of December 31, 2012:

	Pass	Special Mention	Substandard	Doubtful	Total
Grade:					
Commercial and industrial	$ 32,493,477	$ -	$ 2,948,814	$ -	$ 35,442,291
Commercial real estate	36,935,852	3,373,615	528,856	-	40,838,323
Land and construction	6,456,230	-	25,898	-	6,482,128
Residential real estate	14,919,461	-	369,507	-	15,288,968
Agriculture	10,636,805	-	-	-	10,636,805
Consumer	157,366	-	-	-	157,366
	$ 101,599,191	$3,373,615	$ 3,873,075	$ -	$ 108,845,881

NOTE 3 – LOANS (CONTINUED)

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2013:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ -	$ -	$ -	$ -	$ 47,763,877	$ 47,763,877	$ -
Commercial real estate	-	-	-	-	43,579,467	43,579,467	-
Land and construction	-	-	-	-	7,390,927	7,390,927	-
Residential real estate	126,174	-	48,750	174,924	16,560,906	16,735,830	-
Agriculture	-	-	-	-	19,202,344	19,202,344	-
Consumer	-	-	-	-	209,808	209,808	-
Total	$ 126,174	$ -	$ 48,750	$ 174,924	$ 134,707,329	$ 134,882,253	$ -

The following table is an aging analysis of loans, segregated by class of loans, as of December 31, 2012:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
Commercial and industrial	$ 10,441	$249,551	$282,572	$ 542,564	$ 34,899,727	$ 35,442,291	$ 282,572
Commercial real estate	-	-	-	-	40,838,323	40,838,323	-
Land and construction	-	-	-	-	6,482,128	6,482,128	-
Residential real estate	-	-	-	-	15,288,968	15,288,968	-
Agriculture	-	-	-	-	10,636,805	10,636,805	-
Consumer	-	-	-	-	157,366	157,366	-
Total	$ 10,441	$249,551	$282,572	$ 542,564	$ 108,303,317	$ 108,845,881	$ 282,572

NOTE 3 – LOANS (CONTINUED)

During 2013, there were no loans that were modified and considered troubled debt restructurings.

The following tables summarize loans to customers whose loan terms were modified in troubled debt restructurings during the year ended December 31, 2012:

	Year Ended December 31, 2012		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial and industrial	2	$ 1,309,585	$ 1,309,585
Commercial real estate	-	-	-
Land and construction	-	-	-
Residential real estate	-	-	-
Agriculture	-	-	-
Consumer	-	-	-
	2	$ 1,309,585	$ 1,309,585

The loans outlined above are considered troubled debt restructuring because the Bank granted a concession to a borrower experiencing financial difficulties that it would not otherwise consider. During 2012, there were two loans to one borrower that were modified and considered troubled debt restructurings because specific payment term concessions were granted to the borrower. The two troubled debt restructurings for the borrower subsequently defaulted after restructuring and were placed on non-accrual as of December 31, 2012.

The Bank has not committed to lend any additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

Year-end non-accrual loans, segregated by class, are as follows:

	DECEMBER 31, 2013	2012
Commercial and industrial	$ -	$ 1,309,585
Commercial real estate	-	-
Land and construction	-	-
Residential real estate	48,750	74,746
Agriculture	-	-
Consumer	-	-
	$ 48,750	$ 1,384,331

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2013 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 1,425,653	$ 440,053	$ 84,861	$ 169,922	$ 58,587	$ 798	$ 318,265	$ 2,498,139
Charge-offs	(3,015,053)	-	-	(259,045)	-	(1,502)	-	(3,275,600)
Recoveries	25,698	-	-	-	-	100	-	25,798
Provision	2,184,757	570,481	56,534	307,919	147,971	1,123	6,215	3,275,000
Ending balance	$ 621,055	$ 1,010,534	$ 141,395	$ 218,796	$ 206,558	$ 519	$ 324,480	$ 2,523,337
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ -	$ 25,658	$ -	$ -	$ -	$ -	$ -	$ 25,658
Loans collectively evaluated for impairment	621,055	984,876	141,395	218,796	206,558	519	324,480	2,497,679
Ending balance	$ 621,055	$ 1,010,534	$ 141,395	$ 218,796	$ 206,558	$ 519	$ 324,480	$ 2,523,337
Loans:								
Individually evaluated for impairment	$ -	$ 845,109	$ -	$ 124,723	$ -	$ -		$ 969,832
Collectively evaluated for impairment	47,763,877	42,734,358	7,390,927	16,611,107	19,202,344	209,808		133,912,421
Ending balance	$ 47,763,877	$ 43,579,467	$ 7,390,927	$ 16,735,830	$ 19,202,344	$ 209,808		$ 134,882,253

NOTE 3 – LOANS (CONTINUED)

The following table summarizes the Bank's allowance for loan losses for the year ended December 31, 2012 by loan product and collateral type:

	Commercial and Industrial	Commercial Real Estate	Land and Construction	Residential Real Estate	Agriculture	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance	$ 1,142,549	$ 771,406	$ 175,654	$ 242,698	$ 71,259	$ 1,608	$ 387,445	$ 2,792,619
Charge-offs	(256,380)	(432,932)	(392,927)	-	-	(2,241)	-	(1,084,480)
Recoveries	7,000	-	-	-	-	-	-	7,000
Provision	532,484	101,579	302,134	(72,776)	(12,672)	1,431	(69,180)	783,000
Ending balance	$ 1,425,653	$ 440,053	$ 84,861	$ 169,922	$ 58,587	$ 798	$ 318,265	$ 2,498,139
Period-end amount allocated to:								
Loans individually evaluated for impairment	$ 523,834	$ 36,051	$ -	$ -	$ -	$ -	$ -	$ 559,885
Loans collectively evaluated for impairment	901,819	404,002	84,861	169,922	58,587	798	318,265	1,938,254
Ending balance	$ 1,425,653	$ 440,053	$ 84,861	$ 169,922	$ 58,587	$ 798	$ 318,265	$ 2,498,139
Loans:								
Individually evaluated for impairment	$ 1,309,585	$ 1,080,545	$ -	$ 74,746	$ -	$ -		$ 2,464,876
Collectively evaluated for impairment	34,132,706	39,757,778	6,482,128	15,214,222	10,636,805	157,366		106,381,005
Ending balance	$ 35,442,291	$ 40,838,323	$ 6,482,128	$ 15,288,968	$ 10,636,805	$ 157,366		$ 108,845,881

NOTE 4 – PREMISES AND EQUIPMENT

A summary of premises and equipment is as follows:

	DECEMBER 31, 2013	DECEMBER 31, 2012
Leasehold improvements	$ 1,216,391	$ 1,123,897
Furniture, fixtures, and equipment	553,383	469,958
Computer equipment	697,464	630,536
	2,467,238	2,224,391
Less accumulated depreciation and amortization	(1,951,454)	(1,752,585)
	$ 515,784	$ 471,806

The Bank has entered into a ten-year lease for its main banking and administrative offices. The Bank is responsible for common area maintenance, taxes, and insurance to the extent they exceed the base year amounts. The lease expires on January 31, 2016.

At December 31, 2013, the future lease rental payable under non-cancellable operating lease commitments for the Banks' main and administrative offices were as follows:

2014	$ 312,028
2015	321,388
2016	26,848
Thereafter	-
	$ 660,264

The minimum rental payments shown above are given for the existing lease obligations and are not a forecast of future rental expense. Total rental expense was approximately $277,000 for both years ended December 31, 2013 and 2012.

NOTE 5 – DEPOSITS

Customer deposits were as follows:

	DECEMBER 31, 2013	DECEMBER 31, 2012
Non-interest-bearing demand	$ 74,386,391	$ 64,385,021
Savings, NOW, and money market accounts	84,333,796	79,469,098
Time deposits under $100,000	12,200,752	13,786,217
Time deposits $100,000 and over	26,105,925	28,806,991
	$ 197,026,864	$ 186,447,327

At December 31, 2013, the scheduled maturities of time deposits are as follows:

2014	$ 32,195,551
2015	3,693,393
2016	1,124,485
2017	249,000
Thereafter	1,044,248
	$ 38,306,677

NOTE 6 – BORROWING ARRANGEMENTS

The Bank may borrow up to $19,000,000 overnight on an unsecured basis from three correspondent banks. The Bank may also borrow up to approximately $32,840,000 from the Federal Home Loan Bank of San Francisco, subject to providing collateral and fulfilling other conditions of the credit facility. The Bank has pledged investment securities of approximately $5,588,000 for the credit facility at Federal Home Loan Bank of San Francisco. The Bank may also borrow from the Federal Reserve Bank of San Francisco, subject to fulfilling other conditions of the credit facility and providing collateral. As of December 2013 and 2012, no amounts were outstanding under these arrangements.

NOTE 7 – EMPLOYEE BENEFITS

The Bank sponsors an employee stock ownership plan (ESOP) for eligible employees. Eligibility begins after an employee has attained the age of 21 and completed one year of service, as defined in the ESOP documents. Under the ESOP, the Bank contributes a discretionary amount to the ESOP for the purchase of the Bank's stock, to be held in trust for each participant to later be distributed in accordance with the ESOP. For the years ended December 31, 2013 and 2012, contributions to the ESOP were $164,714 and $152,928, respectively.

The Bank sponsors a 401(k) plan for the benefit of its employees. The Bank can match employee contributions and make additional contributions as determined by the Board of Directors annually. The Bank made no contributions for the years ended December 31, 2013 and 2012.

NOTE 8 – INCOME TAXES

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

	2013	2012
Current		
Federal	$ (29,000)	$ 494,000
State	58,000	62,000
	29,000	556,000
Deferred		
Federal	(45,000)	89,000
State	34,000	167,000
	(11,000)	256,000
	$ 18,000	$ 812,000

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition.

NOTE 8 – INCOME TAXES (CONTINUED)

The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statements of financial condition at December 31:

	2013	2012
Deferred tax assets:		
Pre-operating expenses	$ 120,000	$ 137,000
Depreciation differences	230,000	214,000
Allowance for loan losses due to tax limitations	546,000	772,000
Stock-based compensation	274,000	274,000
Operating loss carryforwards	591,000	294,000
Unrealized losses on available-for-sale securities	707,000	-
Other	28,000	163,000
	2,496,000	1,854,000
Deferred tax liabilities:		
Accrual to cash	-	(52,000)
Unrealized gains on available-for-sale securities	-	(441,000)
Other	(76,000)	(100,000)
	(76,000)	(593,000)
Valuation allowance	(66,000)	(66,000)
Net deferred income tax asset	$ 2,354,000	$ 1,195,000

As of December 31, 2013 and 2012, a valuation allowance of $66,000 was recorded for both years equal to the amount of deferred tax assets for certain non-qualified stock options the Bank determined are more likely than not unable to be realized before those options expire. The Bank has net operating loss carryforwards of approximately $805,000 for federal tax purposes that will expire in 2034. The Bank has net operating loss carryforwards of approximately $870,000 for California franchise tax purposes that begin to expire in 2028.

The Bank is subject to federal income tax and franchise tax of the state of California. Income tax returns for the years ended December 31, 2013, 2012, and 2011 are open to audit by the federal authorities and income tax returns for the years ended December 31, 2013, 2012, 2011, 2010, and 2009 are open to audit by state authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next 12 months.

NOTE 9 – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to certain directors and their related interests with which they are associated. The balance of these loans outstanding was approximately $835,000 and $1,238,000 at December 31, 2013 and 2012, respectively.

Deposits from certain directors, officers, and their related interests with which they are associated, held by the Bank at December 31, 2013 and 2012, amounted to approximately $3,524,000 and $2,672,000, respectively.

NOTE 10 – EARNINGS PER SHARE (EPS)

Earnings per share for the years ended December 31 were computed as follows:

	2013	2012
Basic earnings per share:		
Net income	$ 26,091	$ 1,170,688
Accretion of Series A and B preferred stocks	-	(2,722)
Dividends paid on Series A and B preferred stocks	-	(103,050)
Dividends paid on Series C preferred stocks	(305,000)	-
Net (loss) income available to common shareholders	$ (278,909)	$ 1,064,916
Weighted average common shares outstanding	1,873,683	1,868,735
Basic (loss) earnings per share	$ (0.15)	$ 0.57
Diluted earnings per share:		
Net income	$ 26,091	$ 1,170,688
Accretion of Series A and B preferred stocks	-	(2,722)
Dividends paid on Series A and B preferred stocks	-	(103,050)
Dividends paid on Series C preferred stocks	(305,000)	-
Net (loss) income available to common shareholders	$ (278,909)	$ 1,064,916
Weighted average common shares outstanding	1,873,683	1,868,735
Effect of dilutive stock options	-	1,540
Incremental shares from assumed conversion of Series C convertible preferred stock	-	672,525
Adjusted weighted average common shares outstanding	1,873,683	2,542,800
Diluted (loss) earnings per share	$ (0.15)	$ 0.42

At December 31, 2013 and 2012, there were 542,800 and 527,161 stock options, respectively, that could potentially dilute earnings per share in the future that were not included in the computation of diluted earnings per share because to do so would have been antidilutive. All income per share amounts have been retroactively adjusted for the effect of stock dividends.

NOTE 11– COMMITMENTS

In the ordinary course of business, the Bank enters into financial commitments to meet the financing needs of its customers. These financial commitments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk not recognized in the Bank's financial statements.

The Bank's exposure to loan loss in the event of non-performance on commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for loans reflected in the financial statements.

As of December 31, 2013 and 2012, the Bank had the following outstanding financial commitments whose contractual amount represents credit risk:

	2013	2012
Commitments to extend credit	$ 42,508,000	$ 30,760,000
Letters of credit	-	-
	$ 42,508,000	$ 30,760,000

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. Since many of the commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements. The Bank evaluates each client's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank, is based on management's credit evaluation of the customer. The majority of the Bank's commitments to extend credit and standby letters of credit are secured by real estate.

NOTE 12 – STOCK OPTION PLAN

The Bank's 2005 Equity Based Compensation Plan (the Plan) was approved by its shareholders in February 2006. Under the terms of the Plan, officers and key employees may be granted both non-qualified, incentive stock options and restricted stock awards, and directors, who are not also an officer or employee, may only be granted non-qualified stock options and restricted stock awards. The Plan provides for a maximum number of shares that may be awarded to eligible employees and directors not to exceed 495,000 shares. In July 2012, the shareholders approved an additional 183,000 shares to be added to the Plan increasing the total to 678,000 shares. There are 774,782 shares authorized under the Plan. The total number of shares authorized has been retroactively adjusted for the effect of stock dividends. Stock options are granted at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and all equity-based awards generally vest over three years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Bank recognized stock based compensation cost of $59,171 and $62,795 in 2013 and 2012, respectively. The Bank did not recognize tax expense related to stock-based compensation for either year ended December 31, 2013 and 2012.

NOTE 12 – STOCK OPTION PLAN (CONTINUED)

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

	2013	2012
Expected volatility	22.44%	25.30%
Expected term	6.5 years	6.5 years
Expected dividends	None	None
Risk free rate	1.51%	1.07%
Grant date fair value	$ 2.76	$ 2.56

Since the Bank has a limited amount of historical stock activity, the expected volatility is based on the historical volatility of similar banks that have a longer trading history. The expected term represents the estimated average period of time that the options remain outstanding. Since the Bank does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk free rate of return reflects the grant date interest rate offered for U.S. Treasury bonds over the expected term of the options.

A summary of the status of stock options that have been granted by the Bank as of December 31, 2013, and changes during the year ending thereon, is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	528,701	$ 9.15		
Granted	43,850	$ 10.07		
Exercised	(12,414)	$ 8.41		
Forfeited or expired	(17,337)	$ 8.39		
Outstanding at end of year	542,800	$ 9.27	3.9 years	$ 390,275
Options exercisable	478,370	$ 9.24	3.1 years	$ 358,902

As of December 31, 2013, there was approximately $78,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of 2.5 years.

NOTE 13 – REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category. To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

	Actual		For capital adequacy purposes		To be well-capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2013:						
Total Capital (to Risk-Weighted Assets)	$ 24,012	18.9%	$ 10,166	≥ 8.0%	$ 12,708	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 22,412	17.6%	$ 5,083	≥ 4.0%	$ 7,625	≥ 6.0%
Tier I Capital (to Average Assets)	$ 22,412	9.8%	$ 9,124	≥ 4.0%	$ 11,405	≥ 5.0%
December 31, 2012:						
Total Capital (to Risk-Weighted Assets)	$ 23,999	22.2%	$ 8,644	≥ 8.0%	$ 10,805	≥ 10.0%
Tier I Capital (to Risk-Weighted Assets)	$ 22,634	20.9%	$ 4,322	≥ 4.0%	$ 6,483	≥ 6.0%
Tier I Capital (to Average Assets)	$ 22,634	10.8%	$ 8,349	≥ 4.0%	$ 10,436	≥ 5.0%

The California Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lessor of the bank's undivided profits or the bank's net income for its last three fiscal years less any distributions made to shareholders during the same period without the approval in advance of the Commissioner of the California Department of Business Oversight.

NOTE 14 – FAIR VALUE MEASUREMENT

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities – The fair values of securities available-for-sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1) or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for specific securities, but rather by relying on the securities' relationship to other benchmark securities (Level 2).

Loans held for sale – The Bank does not record loans held for sale at fair value on a recurring basis. Loans held for sale are carried at the lower of cost or fair value. The fair value of loans held-for-sale is based on what secondary markets are currently offering for portfolios with similar characteristics (Level 2).

Collateral-dependent impaired loans – The Bank does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect: (1) partial write-downs, through charge offs or specific reserve allowances, that are based on the current appraised or market-quoted value of the underlying collateral, or (2) the full charge off of the loan carrying value. In some cases, the properties for which market quotes or appraisal values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Fair value estimates for collateral-dependent impaired loans are obtained from real estate brokers or other third-party consultants. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Management also considers unobservable inputs regarding market trends or other relevant factors and selling and commission costs of about 15% at December 31, 2013 (Level 3).

Other real estate owned – The Bank utilizes current appraisals or market-quoted values discounted for estimated selling costs to arrive at the estimate of fair value for all other real estate owned. Management also considers unobservable inputs regarding market trends or other relevant factors and selling and commission costs of about 8% at December 31, 2013 (Level 3).

NOTE 14 – FAIR VALUE MEASUREMENT (CONTINUED)

The following table summarizes the Bank's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2013:

Description of Assets	December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 31,691,661	$ -	$ 31,691,661	$ -
Mortgage-backed securities	16,175,950	-	16,175,950	-
State and municipal agencies	14,353,178	-	14,353,178	-
Corporate debt securities	4,117,735	-	4,117,735	-
Impaired loans (non-recurring)	48,750	-	-	48,750
Other real estate owned (non-recurring)	2,023,493	-	-	2,023,493
Total	$ 68,410,767	$ -	$ 66,338,524	$ 2,072,243

The following table summarizes the Bank's assets that were measured at fair value on a recurring and non-recurring basis at December 31, 2012:

Description of Assets	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available-for-sale (recurring)				
U.S. government and agency securities	$ 35,725,909	$ -	$ 35,725,909	$ -
Mortgage-backed securities	13,111,705	-	13,111,705	-
State and municipal agencies	11,061,334	-	11,061,334	-
Corporate debt securities	4,022,750	-	4,022,750	-
Other real estate owned (non-recurring)	2,223,493	-	-	2,223,493
Total	$ 66,145,191	$ -	$ 63,921,698	$ 2,223,493

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. 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 entire holdings of a particular financial instrument. Because no market value exists for a significant portion of the 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, involve uncertainties and matters of judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used by the Bank in estimating fair values of financial instruments:

Financial assets – The carrying amounts of cash, short-term investments due from customers on acceptances, and bank acceptances outstanding are considered to approximate fair value. Short-term investments include federal funds sold, securities purchased under agreements to resell, and interest bearing deposits with banks. The fair values of investment securities, including available for sale and held to maturity, are generally based on quoted market prices. The fair value of variable loans that reprice frequently and that have experienced no significant change in credit risk is based on carrying values. The fair values for all other loans are estimated using discounted cash flow analyses and interest rates currently being offered for loans with similar terms to borrowers with similar credit quality. Loans are generally expected to be held to maturity and any unrealized gains or losses are not expected to be realized. Fair value for Federal Home Loan Bank stock and interest receivable approximates its carrying value.

Financial liabilities – The carrying amounts of deposit liabilities payable on demand, commercial paper, and other borrowed funds are considered to approximate fair value. For fixed maturity deposits, fair value is estimated by discounting estimated future cash flows using currently offered rates for deposits of similar remaining maturities. The fair value of interest payable approximates its carrying amount.

NOTE 15 – FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Off-balance sheet financial instruments – The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the credit standing of the counterparties.

The estimated fair value of financial instruments at December 31 is summarized as follows (in thousands):

	2013			2012		
	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Fair Value Hierarchy
Financial assets:						
Cash and cash equivalents	$ 9,795	$ 9,795	Level 1	$ 32,858	$ 32,858	Level 1
Securities available-for-sale	66,339	66,339	Level 2	63,922	63,922	Level 2
Loans, net	132,491	135,105	Level 3	106,465	111,282	Level 3
Loans held for sale	1,060	1,088	Level 2	-	-	
Correspondent bank stock	1,128	1,128	Level 2	942	942	Level 2
Interest receivable	1,049	1,049	Level 2	886	886	Level 2
Financial liabilities:						
Deposits	197,027	197,245	Level 2	186,447	186,860	Level 2
Interest payable	33	33	Level 2	31	31	Level 2
Off-balance-sheet liabilities:						
Commitments to extend credit and letters of credit	-	425	Level 3	-	308	Level 3

NOTE 16 – PREFERRED STOCK

On January 23, 2009, the Bank, in connection with the Troubled Assets Relief Program (TARP) Capital Purchase Program, entered into a Purchase Agreement with the United States Department of the Treasury (the U.S. Treasury), pursuant to which the Bank issued 1,968 shares of the Bank's Preferred Stock as Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock) and 98 shares of Fixed Rate Non-Cumulative Perpetual Warrant Preferred Stock, Series B (the Series B Preferred Stock) for an aggregate purchase price of $1,968,000 in cash. Series A Preferred Stock pays non-cumulative dividends at a rate of 5% per annum for the first five years and 9% per annum thereafter. Series B Preferred Stock pays non-cumulative dividends at a rate of 9% per annum. In November 2012, the Bank redeemed 1,968 shares of Series A Preferred Stock for $1,000 per share and 98 shares of Series B Preferred Stock for $1,000 per share from the U.S. Treasury. The total redemption price was $2,066,000. With the redemption of all outstanding shares of its Series A and Series B Preferred Stocks from the U.S. Treasury, the Bank concluded its participation in the TARP Capital Purchase Program.

NOTE 16 – PREFERRED STOCK (CONTINUED)

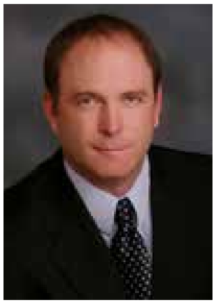
During 2012, the Bank issued 61,000 shares of Series C mandatorily convertible non-cumulative perpetual Preferred Stock at a price of $100.00 per share. Series C Preferred Stock pays non-cumulative dividends at 5% per annum and is mandatorily convertible to shares of common stock at a conversion price of $10.00 per share the day after the third anniversary of the issuance of the Series C Preferred Stock. This will result in the receipt of ten shares of common stock for each share of Series C Preferred Stock. Prior to that time, the Series C Preferred Stock is convertible into the Bank's common stock at the election of the holder at the same $10.00 per share conversion price. In the event of a stock split, reverse stock split, stock dividend, reorganization, or recapitalization affecting the number of shareholders of the common stock outstanding, the conversion ratio shall be proportionately revised to preserve the conversion rights of the Series C Preferred Stock. Offering costs associated with this capital campaign totaled $384,962. Total proceeds, net of related offering costs, totaled $5,715,038.

NOTE 17 – SUBSEQUENT EVENTS

The Bank has evaluated the effects of subsequent events that have occurred after the period ending December 31, 2013 and through March 26, 2014, which is the date the financial statements were issued.

FRESNO FIRST BANK

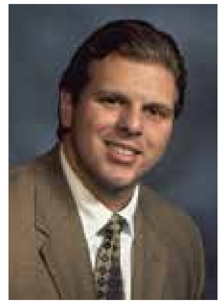
Board of Directors



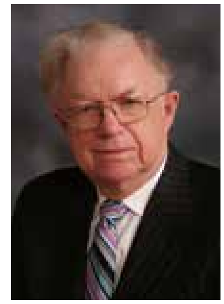
Jack Holt,
Director / President of Holt Lumber Company, Inc.

Dr. Robert Kubo,
Director/Orthodontist, Kubo Orthodontic Group

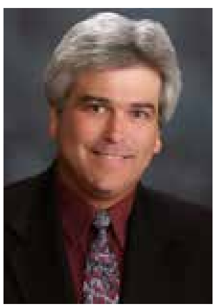
Lorrie Lorenz,
Director / Principal of Lorenz & Associates



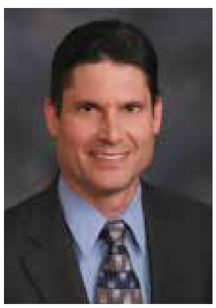
Jared Martin,
Director / Realtor, Keller Williams Realty



David Price,
Chairman of the Board / President and CEO of David N. Price & Associates



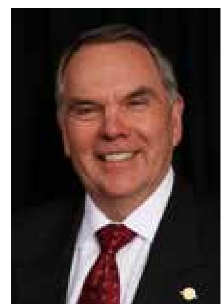
Mark Saleh,
Director / President of Wm. B. Saleh & Company



Joel Slonski,
Director / CPA with Slonski & Sailors

Al Smith,
Director / President and CEO of the Greater Fresno Area Chamber of Commerce

Dr. Daniel Suchy,
Director / Retired Physician



Richard Whitsell,
Director / President and CEO of Fresno First Bank

Since the founding of our Bank in 2005, our dedicated Board of Directors has provided leadership and an unwavering commitment to the strength of the Bank and the communities we serve.

At Fresno First Bank we believe that corporate governance begins with a well educated and informed Board, Management and Staff. Our Directors participate in a rigorous education program and actively participate in conferences conducted by the Western Independent Bankers, the National Association of Corporate Directors, the California Bankers Association and various regulatory compliance courses throughout the year. The Bank's Chairman, David Price is also a member of the WIB Advisory Committee for the Annual Bank Chairman's Forum and a regular participant in the Annual Corporate Governance Conference.

Our Board of Directors and the employees of Fresno First Bank also actively support a number of non-profit organizations throughout the year. Some of which include the American Heart Association, American Red Cross, Community Food Bank, Habitat for Humanity, United Cerebral Palsy, Valley Crime Stoppers, Exceptional Parents Unlimited, Salvation Army and many other local non-profit organizations.

Fresno First Bank
Employee Owners

Rick Whitsell – President & CEO
Steve Canfield – EVP/Chief Financial Officer
Lee Reed – EVP/Chief Credit Officer
Evangelina Gonzalez, SVP/Operations
Craig DeShields, SVP/Senior Loan Officer
Michael Fanucchi, SVP/SBA Department Manager
Robert Longatti, SVP/Business Development
Ken Dodderer, SVP/Agri-Business Manager
David Kraechan, SVP/Commercial Loan Officer
Debbie Cameron, VP/Executive Secretary
Lanny Chan, VP/Personal Banker
Teresa Palsgaard, VP/Relationship Manager
Jennifer Peterson, VP, Customer Service Manager
Alice Shevenell, VP/Loan Services Manager
Catherine Fitzgerald, VP/Merchant Sales and Services
Jeane Vaissade, VP/Regional Manager-Sacramento
Keith Wolaridge, VP/SBA Loan Officer-Bakersfield
Julie Henvit, AVP/Operations Officer
Lisa Bassill, AVP/ New Accounts
Jarod Ashton, AVP/Commercial Loan Officer
Ruth Setencich, New Accounts
Kamran Assemi, Credit Analyst
Melissa Gamez, Accounting Assistant
Tobi Burnes, Loan Documentation Clerk
Margaret Rodriguez, Loan Assistant
Kimberly Spenhoff, Loan Assistant
Candy Jones, Senior Vault Teller
Mary Edsberg, Loan Assistant
Ana Coria, Customer Service Representative
Melanie Welch, SBA Loan Processor
Noel Terriquez, Customer Service Representative
Elizabeth Parsons, SBA Processor

Fresno First Bank •7690 N. Palm Avenue • Fresno, California 93711
559.439.0200 • www.fresnofirstbank.com

FRESNO FIRST BANK

Corporate Information

Annual Meeting of Shareholders

Tuesday, June 24, 2014 at 5:30 pm
Fort Washington Country Club
10272 N. Millbrook
Fresno, CA 93730

Corporate Office:

Fresno First Bank
7690 N. Palm Avenue, Suite 101
Fresno, CA 93711
559.439.0200

Transfer Agent:

Continental Stock Transfer & Trust Co.
17 Battery Place
New York, NY
212.509.4000

Independent Auditors:

Moss Adams, LLP
3121 West March Lane, Suite 100
Stockton, CA 95219
209.955.6100

Legal Counsel:

Stuart & Moore
641 Higuera Street, Suite 302
San Luis Obispo, CA 93401
805.545.8590

Stock Facilitators:

Michael Natzic - Crowell, Weedon & Co
800.288.2811

Joey Warmerhoven – McAdams Wright Ragen Inc.
866.662.0351

Tom Weil – RBC Dain Rauscher
888.883.8207

Robert Cook - Fig Partners, LLC
866.344.2657

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