FIRST NORTHERN COMMUNITY BANCORP
Form 10-Q
August 08, 2008

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

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2008

OR

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

For the transition period from _______________ to _______________

Commission File Number 000-30707

First Northern Community Bancorp
(Exact name of registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	68-0450397 (I.R.S. Employer Identification Number)
195 N. First Street, Dixon, California (Address of principal executive offices)	95620 (Zip Code)

707-678-3041
(Registrant's telephone number including area code)

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

Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer x	Non-accelerated filer ¨	Smaller reporting company ¨

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

Yes ¨ No x

The number of shares of Common Stock outstanding as of August 7, 2008 was 8,607,597.

FIRST NORTHERN COMMUNITY BANCORP

INDEX

		Page
PART I: FINANCIAL INFORMATION		
Item 1	Financial Statements	
	Unaudited Condensed Consolidated Balance Sheets	3
	Unaudited Condensed Consolidated Statements of Income	4
	Unaudited Condensed Consolidated Statement of Stockholders' Equity and Comprehensive Income	5
	Unaudited Condensed Consolidated Statements of Cash Flows	6
	Notes to Unaudited Condensed Consolidated Financial Statements	7
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3	Quantitative and Qualitative Disclosures About Market Risk	33
Item 4	Controls and Procedures	33
PART II: OTHER INFORMATION		
Item 1A	Risk Factors	34
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 4	Submission of Matters to a Vote of Security Holders	36
Item 6	Exhibits	37
Signatures		37

PART I - FINANCIAL INFORMATION

ITEM 1.

FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	(UNAUDITED) June 30, 2008	December 31, 2007
ASSETS		
Cash and due from banks	$ 49,642	$ 52,090
Federal funds sold	715	46,940
Investment securities – available-for-sale	56,053	74,849
Loans, net of allowance for loan losses of		
$12,096 at June 30, 2008 and $10,876 at December 31, 2007	512,229	497,971
Loans held-for-sale	1,154	1,343
Stock in Federal Home Loan Bank and other equity securities, at cost	2,257	2,199
Premises and equipment, net	7,960	7,872
Other Real Estate Owned	5,729	879
Accrued interest receivable and other assets	25,636	25,752
TOTAL ASSETS	$ 661,375	$ 709,895
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Demand deposits	$ 172,528	$ 193,258
Interest-bearing transaction deposits	130,866	135,381
Savings and MMDA's	165,323	178,137
Time, under $100,000	43,022	46,411
Time, $100,000 and over	62,036	69,484
Total deposits	573,775	622,671
FHLB Advances and other borrowings	20,166	15,832
Accrued interest payable and other liabilities	6,008	7,417
TOTAL LIABILITIES	599,949	645,920
Stockholders' equity		
Common stock, no par value; 16,000,000 shares authorized;		
8,577,689 shares issued and outstanding at June 30, 2008 and 8,169,772 shares issued and outstanding at December 31, 2007	58,507	50,956
Additional paid in capital	977	977
Retained earnings	2,595	12,209
Accumulated other comprehensive loss	(653)	(167)
TOTAL STOCKHOLDERS' EQUITY	61,426	63,975
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 661,375	$ 709,895

See notes to unaudited condensed consolidated financial statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share amounts)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Interest and Dividend Income				
Loans	$ 8,540	$ 10,379	$ 17,780	$ 20,754
Federal funds sold	127	992	417	1,852
Due from banks interest bearing accounts	144	—	412	—
Investment securities				
Taxable	342	684	840	1,334
Non-taxable	328	302	686	580
Other earning assets	37	31	66	60
Total interest and dividend income	9,518	12,388	20,201	24,580
Interest Expense				
Deposits	1,441	3,098	3,353	5,990
Other borrowings	61	89	147	166
Total interest expense	1,502	3,187	3,500	6,156
Net interest income	8,016	9,201	16,701	18,424
Provision for loan losses	2,763	430	6,422	260
Net interest income after provision for loan losses	5,253	8,771	10,279	18,164
Other operating income				
Service charges on deposit accounts	929	816	1,853	1,609
(Losses) gains on other real estate owned	(583)	179	(652)	179
Gains on sales of loans held-for-sale	74	138	174	184
Investment and brokerage services income	207	37	384	104
Mortgage brokerage income	12	8	13	77
Loan servicing income	112	91	159	166
Fiduciary activities income	76	80	173	145
ATM fees	69	73	138	139
Signature based transaction fees	152	129	291	243
(Losses) gains on sales of available-for-salesecurities	(16)	—	495	—
Other income	188	157	395	360
Total other operating income	1,220	1,708	3,423	3,206
Other operating expenses				
Salaries and employee benefits	3,959	4,337	8,066	8,810
Occupancy and equipment	952	899	1,864	1,897
Data processing	419	385	818	793
Stationery and supplies	171	141	287	287
Advertising	191	218	366	429
Directors’ fees	53	46	105	100

Other real estate owned expense		26		18		35		18
Other expense		1,556		1,383		2,958		2,739
Total other operating expenses		7,327		7,427		14,499		15,073
(Loss) income before income tax expense		(854)		3,052		(797)		6,297
Provision for income taxes		10		1,067		7		2,222
Net (loss) income	$	(864)	$	1,985	$	(804)	$	4,075
Basic (Loss) Income per share	$	(0.10)	$	0.22	$	(0.09)	$	0.46
Diluted (Loss) Income per share	$	(0.10)	$	0.22	$	(0.09)	$	0.44

See notes to unaudited condensed consolidated financial statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENT
OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME
(in thousands, except share amounts)

	Common Stock		Comprehensive (Loss)	Additional Paid-in	Retained	Accumulated Other Comprehensive	
	Shares	Amounts	Income	Capital	Earnings	Loss	Total
Balance at December 31, 2007	8,169,772	$ 50,956	$ 977	$ 12,209	$ (167)	$ 63,975	
Cumulative effect of adoption of EITF 06-04					(158)		(158)
Comprehensive (loss) income							
Net loss			$ (804)		(804)		(804)
Other comprehensive (loss) income:							
Unrealized holding losses on securities arising during the current period, net of tax effect of $250			(374)				
Reclassification adjustment due to gains realized on sales of securities, net of tax effect of $198			(297)				
Directors' and officers' retirement plan equity adjustments, net of tax effect of $124			185				
Total other comprehensive loss, net of tax effect of $324			(486)			(486)	(486)

Comprehensive loss			$ (1,290)				
6% stock dividend	486,542	8,642		(8,642)		—	
Cash in lieu of fractional shares					(10)		(10)
Stock-based compensation and related tax benefits		268				268	
Stock options exercised, net of swapped shares	6,790	—				—	
Stock repurchase and retirement	(85,415)	(1,359)				(1,359)	
Balance at June 30, 2008	8,577,689	$ 58,507	$ 977	$ 2,595	$ (653)	$ 61,426	

See notes to unaudited condensed consolidated financial statements.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	(in thousands)	
	Six months ended June 30, 2008	Six months ended June 30, 2007
Operating Activities		
Net (Loss) Income	$ (804)	$ 4,075
Adjustments to reconcile net income to net cash		
provided by operating activities:		
Depreciation and amortization	530	596
Provision for loan losses	6,422	260
Stock plan accruals	248	301
Tax benefit for stock options	20	82
Gains on sales of available-for-sale securities	(495)	—
Losses (gains) on sales of other real estate owned	652	(179)
Gains on sales of loans held-for-sale	(174)	(184)
Proceeds from sales of loans held-for-sale	21,177	22,350
Originations of loans held-for-sale	(20,814)	(25,949)
Increase in accrued interest receivable and other assets	(956)	(2,383)
Decrease in accrued interest payable and other liabilities	(1,409)	(1,601)
Net cash provided by (used in) operating activities	4,397	(2,632)
Investing Activities		
Net decrease (increase) in investment securities	19,739	(14,254)
Net increase in loans	(26,182)	(6,001)
Net increase in other interest earning assets	(58)	(53)
Purchases of premises and equipment, net	(618)	(663)
Net cash used in investing activities	(7,119)	(20,971)
Financing Activities		
Net (decrease) increase in deposits	(48,896)	7,865
Net increase in FHLB advances and other borrowings	4,334	208
Cash dividends paid	(10)	(13)
Stock options exercised	—	87
Tax benefit for stock options	(20)	(82)
Repurchase of stock	(1,359)	(2,438)
Net cash (used in) provided by financing activities	(45,951)	5,627
Net decrease in cash and cash equivalents	(48,673)	(17,976)
Cash and cash equivalents at beginning of period	99,030	98,001
Cash and cash equivalents at end of period	$ 50,357	$ 80,025
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 3,731	$ 6,197
Income Taxes	$ 340	$ 2,952
Supplemental disclosures of non-cash investing and financing activities:		
Transfer of loans held-for-investment to other real estate owned	$ 5,502	$ 1,100

Stock dividend distributed	$ 8,642	$ 10,851

See notes to unaudited condensed consolidated financial statements.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2008 and 2007 and December 31, 2007

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of First Northern Community Bancorp (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Articles 9 and 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of results expected for the full year. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report to stockholders and Form 10-K for the year ended December 31, 2007 as filed with the Securities and Exchange Commission. The preparation of financial statements in conformity with GAAP also requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates. All material intercompany balances and transactions have been eliminated in consolidation.

Recently Issued Accounting Pronouncements:

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard was effective for the Company in the fiscal year beginning January 1, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company's financial position and results of operations. See footnote 8 "Fair Value Measurement" for further information.

In February 2008, the FASB issued Staff Position (FSP) 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of FAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods with those fiscal years. The expected impact of adoption will not be material.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." Under this Standard, the Company may elect to report many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis with changes in value reported in earnings each reporting period. This election is irrevocable. SFAS No. 159 provides an opportunity to mitigate volatility in reported earnings that is caused by measuring hedged assets and liabilities that were previously required to use a different accounting method than the related hedging contracts when the complex provisions of SFAS No. 133 hedge accounting are not met. SFAS No. 159 was effective for the Company in the fiscal year beginning January 1, 2008. The Company did not choose to report additional assets and liabilities at fair value other than those required to be accounted at fair value prior to the adoption of SFAS No. 159. The adoption of SFAS No. 159 did not have a material impact on the Company's financial position and results of operations.

In September 2006, the Emerging Issues Task Force issued EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with SFAS No. 106 (if, in substance, a postretirement benefit plan exits) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus was effective for the Company in the fiscal year beginning January 1, 2008. The adoption of EITF 06-4 did not have a material impact on the Company's financial position and results of operations.

In November 2007, EITF Issue No. 07-6, Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, Accounting for Sales of Real Estate, When the Agreement Includes a Buy-Sell Clause, was issued. The Task Force reached a consensus that a buy-sell clause in a sale of real estate that otherwise qualifies for partial sale accounting does not by itself constitute a form of continuing involvement that would preclude partial sale accounting under SFAS No. 66, Accounting for Sales of Real Estate. However, continuing involvement could be present if the buy-sell clause in conjunction with other implicit and explicit terms of the arrangement indicate that the seller has an obligation to repurchase the property, the terms of the transaction allow the buyer to compel the seller to repurchase the property, or the seller can compel the buyer to sell its interest in the property back to the seller. The consensus is effective for fiscal years beginning after December 15, 2007. The consensus applies to new assessments made under SFAS No. 66 after January 1, 2008. The adoption of EITF Issue No. 07-6 did not have a material impact on the Company's financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements, which will require non-controlling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. SFAS No. 160 applies to the accounting for non-controlling interests and transactions with non-controlling interest holders in consolidated financial statements. SFAS No. 160 is effective for periods beginning on or after December 15, 2008. Earlier application is prohibited. SFAS No. 160 will be applied prospectively to all non-controlling interests, including any that arose before the effective date except that comparative period information must be recast to classify non-controlling interests in equity, attribute net income and other comprehensive income to non-controlling interests, and provide other disclosures required by SFAS No. 160. The Company does not expect the adoption of SFAS No. 160 to have any material impact on the consolidated financial statements or results of operations of the Company.

Reclassifications

Certain reclassifications have been made to prior period balances in order to conform to the current year presentation.

2. ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at levels considered adequate by management to provide for loan losses that can be reasonably anticipated. The allowance is based on management's assessment of various factors affecting the loan portfolio, including problem loans, economic conditions and loan loss experience, and an overall evaluation of the quality of the underlying collateral.

Changes in the allowance for loan losses during the six-month periods ended June 30, 2008 and 2007 and for the year ended December 31, 2007 were as follows:

(in thousands)

	Six months ended June 30,		Year ended December 31,
	2008	2007	2007
Balance, beginning of period	$ 10,876	$ 8,361	$ 8,361
Provision for loan losses	6,422	260	4,795
Loan charge-offs	(5,529)	(631)	(3,060)
Loan recoveries	327	394	780
Balance, end of period	$ 12,096	$ 8,384	$ 10,876

3. MORTGAGE OPERATIONS

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

The Company recognizes a gain and a related asset for the fair value of the rights to service loans for others when loans are sold. The Company sold substantially its entire conforming long-term residential mortgage loans originated during the six months ended June 30, 2008 for cash proceeds equal to the fair value of the loans.

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

At June 30, 2008, the Company had $1,154,000 of mortgage loans held-for-sale. At June 30, 2008 and December 31, 2007, the Company serviced real estate mortgage loans for others of $116,273,000 and $116,310,000, respectively.

The following table summarizes the Company's mortgage servicing rights assets as of June 30, 2008 and December 31, 2007.

	(in thousands)			
	December 31, 2007	Additions	Reductions	June 30, 2008
Mortgage servicing rights	$ 956	$ 116	$ 91	$ 981
Valuation allowance	—	(14)	—	(14)
Mortgage servicing rights, net of valuation allowance	$ 956	$ 102	$ 91	$ 967

There was no valuation allowance recorded for mortgage servicing rights as of December 31, 2007.

4. OUTSTANDING SHARES AND EARNINGS PER SHARE

On January 24, 2008, the Board of Directors of the Company declared a 6% stock dividend paid March 31, 2008 to stockholders of record as of February 29, 2008.

Earnings per share amounts have been adjusted retroactively to reflect the effects of the stock dividend.

Earnings Per Share (EPS)

Basic EPS includes no dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted EPS includes all common stock equivalents ("in-the-money" stock options, unvested restricted stock, stock units, warrants and rights, convertible bonds and preferred stock), which reflects the potential dilution of securities that could share in the earnings of an entity.

The following table presents a reconciliation of basic and diluted EPS for the three-month and six-month periods ended June 30, 2008 and 2007.

	(in thousands, except share and earnings per share amounts)			
	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Basic earnings per share:				
Net (loss) income	$ (864)	$ 1,985	$ (804)	$ 4,075
Weighted average common shares outstanding	8,577,735	8,869,599	8,625,636	8,894,454
Basic EPS	$ (0.10)	$ 0.22	$ (0.09)	$ 0.46
Diluted earnings per share:				
Net (loss) income	$ (864)	$ 1,985	$ (804)	$ 4,075
Weighted average common shares outstanding	8,577,735	8,869,599	8,625,636	8,894,454
Effect of dilutive options	—	240,023	—	439,139
Adjusted weighted average common shares outstanding	8,577,753	9,109,622	8,625,636	9,333,593
Diluted EPS	$ (0.10)	$ 0.22	$ (0.09)	$ 0.44

Options not included in the computation of diluted earnings per share because they would have had an anti-dilutive effect amounted to 120,506 shares and 112,171 shares for the three months ended June 30, 2008 and 2007, respectively.

Options not included in the computation of diluted earnings per share because they would have had an anti-dilutive effect amounted to 118,108 shares and 111,714 shares for the six months ended June 30, 2008 and 2007, respectively.

5. STOCK PLANS

The following table presents the activity related to stock options and restricted stock for the three months ended June 30, 2008.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term (in years)
Options outstanding at Beginning of Period	571,235	$ 10.47		
Granted	—	—		
Cancelled / Forfeited	—	—		
Exercised	(7,090)	$ 3.96	$ 72,956	
Options outstanding at End of Period	564,145	$ 10.55	$ 1,890,540	5.35
Exercisable (vested) at End of Period	436,180	$ 9.51	$ 1,519,768	4.52

The following table presents the activity related to stock options and restricted stock for the six months ended June 30, 2008.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Options outstanding at Beginning of Period	542,221	$ 10.78		
Granted	31,464	$ 4.66		
Cancelled / Forfeited	(297)	$ 21.83		
Exercised	(9,243)	$ 3.76	$ 97,143	
Options outstanding at End of Period	564,145	$ 10.55	$ 1,890,540	5.35
Exercisable (vested) at End of Period	436,180	$ 9.51	$ 1,519,768	4.52

The weighted average fair value of options and restricted stock granted during the six-month period ended June 30, 2008 was $12.11 per share.

As of June 30, 2008, there was $772,278 of total unrecognized compensation cost related to non-vested stock options and restricted stock. This cost is expected to be recognized over a weighted average period of approximately 1.90 years.

There was $205,332 of recognized compensation cost related to non-vested stock options and restricted stock for the three-month period ended June 30, 2008.

A summary of the weighted average assumptions used in valuing stock options during the three months and six months ended June 30, 2008 is presented below:

	Three Months Ended June 30, 2008*	Six Months Ended June 30, 2008
Risk Free Interest Rate	—	2.76%
Expected Dividend Yield	—	0.0%
Expected Life in Years	—	5.00
Expected Price Volatility	—	27.92%

* There were no stock options or restricted stock granted during the three-month period ended June 30, 2008.

The Company has a 2000 Employee Stock Purchase Plan ("ESPP"). Under the plan, the Company is authorized to issue to eligible employees shares of common stock. There are 280,900 (adjusted for the 2008 stock dividend) shares authorized under the ESPP. The ESPP will terminate February 27, 2017. The ESPP is implemented by participation periods of not more than twenty-seven months each. The Board of Directors determines the commencement date and duration of each participation period. The Board of Directors approved the current participation period of November 24, 2007 to November 23, 2008. An eligible employee is one who has been continually employed for at least ninety (90) days prior to commencement of a participation period. Under the terms of the ESPP, employees can choose to have up to 10 percent of their compensation withheld to purchase the Company's common stock each participation period. The purchase price of the stock is 85 percent of the lower of the fair market value on the last trading day before the date of participation or the fair market value on the last trading day during the participation period.

As of June 30, 2008, there was $43,500 of unrecognized compensation cost related to ESPP grants. This cost is expected to be recognized over a weighted average period of approximately 0.50 years.

There was $43,500 of recognized compensation cost related to ESPP grants for the six-month period ended June 30, 2008.

The weighted average fair value at grant date during the six-month period ended June 30, 2008 was $4.67.

A summary of the weighted average assumptions used in valuing ESPP grants during the three months and six months ended June 30, 2008 is presented below:

	Three Months Ended June 30, 2008	Six Months Ended June 30, 2007
Risk Free Interest Rate	3.28%	3.28%
Expected Dividend Yield	0.00%	0.00%
Expected Life in Years	1.00	1.00
Expected Price Volatility	31.90%	31.90%

6. EXECUTIVE SALARY CONTINUATION PLAN

The Company has an unfunded noncontributory defined benefit pension plan provided in two forms to a select group of highly compensated employees.

Four executives have Salary Continuation Plans providing retirement benefits between $50,000 and $100,000 based on responsibilities and tenure at the Company. The retirement benefits are paid for 10 years following retirement at age 65. Reduced retirement benefits are available after age 55 and 10 years of service.

The Supplemental Executive Retirement Plan is intended to provide a fixed annual benefit for 10 years plus 6 months for each full year of service over 10 years (limited to 180 months total) subsequent to retirement at age 65. Reduced benefits are payable as early as age 55 if the participant has at least 10 years of service. Two employees currently have Supplemental Executive Retirement Plan agreements. The agreements provide a target benefit of 2% (2.5% for the CEO) times years of service times final average compensation. Final average compensation is defined as three-year average salary plus seven-year average bonus. The target benefit is reduced by benefits from social security and the Company's profit sharing plan. The maximum target benefit is 50% of final average compensation.

	Three months ended June,	
	2008	2007
Components of Net Periodic Benefit Cost		
Service Cost	$ 33,232	$ 30,383
Interest Cost	29,684	28,784
Amortization of prior service cost	21,821	21,821
Net periodic benefit cost	$ 84,737	$ 80,988

The Company estimates that the annual net periodic benefit cost will be $336,855 for the year ended December 31, 2008. This compares to an annual net periodic benefit cost of $323,948 for the year ended December 31, 2007.

Estimated Contributions for Fiscal 2008

For unfunded plans, contributions to the Executive Salary Continuation Plan are the benefit payments made to participants. At December 31, 2007 the Company expected to make benefit payments of $54,144 in connection with the Executive Salary Continuation Plan during fiscal 2008.

7. DIRECTORS' RETIREMENT PLAN

The Company has an unfunded noncontributory defined benefit pension plan ("Directors' Retirement Plan"). The Directors' Retirement Plan provides a retirement benefit equal to $1,000 per year of service as a director up to a maximum benefit of $15,000. The retirement benefit is payable monthly for 10 years following retirement at age 65. Reduced retirement benefits are available after age 55 and 10 years of service.

	Three months ended June 30,	
	2008	2007
Components of Net Periodic Benefit Cost		
Service Cost	$ 14,424	$ 14,366
Interest Cost	7,731	6,736
Amortization of net loss	—	121
Net periodic benefit cost	$ 22,155	$ 21,223

The Company estimates that the annual net periodic benefit cost will be $88,622 for the year ended December 31, 2008. This compares to annual net periodic benefit costs of $84,890 for the year ended December 31, 2007.

Estimated Contributions for Fiscal 2008

For unfunded plans, contributions to the Directors' Retirement Plan are the benefit payments made to participants. At December 31, 2007 the Company expected to make cash contributions of $15,000 to the Directors' Retirement Plan during fiscal 2008.

8. FAIR VALUE MEASUREMENT

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading securities and derivatives are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans held for sale, loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Fair Value Hierarchy

Under SFAS No. 157, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques and include management judgment and estimation which may be significant.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available-for-Sale

Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans Held for Sale

Loans held for sale are carried at the lower of cost or market value. The fair value of loans held for sale is based on what secondary markets are currently offering for portfolios with similar characteristics. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2.

16

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, the Company measures impairment in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan" (SFAS No. 114). The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2008, substantially all of the total impaired loans were evaluated based on the fair value of the underlying collateral securing the loan. In accordance with SFAS No. 157, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Loan Servicing Rights

Loan servicing rights are subject to impairment testing. A valuation model, which utilizes a discounted cash flow analysis using interest rates and prepayment speed assumptions currently quoted for comparable instruments and a discount rate determined by management, is used in the completion of impairment testing. If the valuation model reflects a value less than the carrying value, loan servicing rights are adjusted to fair value through a valuation allowance as determined by the model. As such, the Company classifies loan servicing rights subjected to nonrecurring fair value adjustments as Level 3.

Assets Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 by SFAS No. 157 valuation hierarchy.

(in thousands)

June 30, 2008	Total	Level 1	Level 2	Level 3
Investment securities available-for-sale	$ 56,053	$ 2,273	$ 53,780	$ —
Total investments at fair value	$ 56,053	$ 2,273	$ 53,780	$ —

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period.

Assets measured at fair value on a nonrecurring basis are included in the table below by level within the fair value hierarchy as of June 30, 2008.

(in thousands)

June 30, 2008	Total	Level 1	Level 2	Level 3

Impaired loans	$	14,098	$	—	$	8,381	$	5,717
Loan servicing rights		967		—		—		967
Total impaired loans and loan servicing rights at fair value	$	15,065	$	—	$	8,381	$	6,684

17

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and subject to the "safe harbor" created by those sections. Forward-looking statements include the information concerning possible or assumed future results of operations of the Company set forth under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this Report. Forward-looking statements also include statements in which words such as "expect," "anticipate," "intend," "plan," "believe," estimate," "consider" or similar expressions are used, and include assumptions concerning the Company's operations, future results and prospects. These forward-looking statements are based upon current expectations and are subject to risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from those set forth in or implied by the forward-looking statements and related assumptions. Some factors that may cause actual results to differ from the forward-looking statements include the following: (i) the effect of changing regional and national economic conditions, including the continuing fiscal challenges for the State of California; (ii) uncertainty regarding the economic outlook resulting from the continuing hostilities in Iraq and the war on terrorism, as well as actions taken or to be taken by the United States or other governments as a result of further acts or threats of terrorism; (iii) significant changes in interest rates and prepayment speeds; (iv) credit risks of commercial, agricultural, real estate, consumer and other lending activities; (v) adverse effects of current and future federal and state banking or other laws and regulations or governmental fiscal or monetary policies; (vi) competition in the banking industry; (vii) changes in demand for loan products and other bank products; (viii) changes in accounting standards; and (ix) other external developments which could materially impact the Company's operational and financial performance. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made. For additional information concerning risks and uncertainties related to the Company and its operations, please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007 and Item 1A. of Part II of this Report.

The following is a discussion and analysis of the significant changes in the Company's Unaudited Condensed Consolidated Balance Sheets and of the significant changes in income and expenses reported in the Company's Unaudited Condensed Consolidated Statements of Income and Stockholders' Equity and Comprehensive Income as of and for the three-month and six-month periods ended June 30, 2008 and 2007 and should be read in conjunction with the Company's consolidated 2007 financial statements and the notes thereto contained in the Company's Annual Report to Stockholders and Form 10-K for the year ended December 31, 2007, along with other financial information included in this Report.

INTRODUCTION

This overview of Management's Discussion and Analysis highlights selected information in this Report and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting estimates, you should carefully read this entire Report, together with our Consolidated Financial Statements and the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

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

Significant results and developments during the second quarter and year-to-date 2008 include:

- Net loss of $0.80 million for the six months ended June 30, 2008, down 119.6% from the $4.08 million earned in the same fiscal period last year. (First half 2008 net income was decreased by a $3.79 million, net of tax, provision for loan losses. First half 2007 net income was decreased by a $153 thousand, net of tax, provision for loan losses.)

- Diluted (loss) per share for the six months ended June 30, 2008 was ($0.09), down 120.5% from the diluted income per share of $0.44 reported in the same period last year (per share data has been adjusted for stock dividends).

- Net interest income decreased in the six months ended June 30, 2008 by $1.7 million, or 9.2%, to $16.7 million from $18.4 million in the same period last year. The decrease in net interest income was primarily attributable to decreases in the average volume of interest-earning assets combined with a decrease in interest yields, which was partially offset by decreases in interest-bearing deposits combined with a decrease in interest costs. Net interest margin decreased from 5.87% for the six-month period ending June 30, 2007 to 5.43% for the same period ending June 30, 2008.

- Provision for loan losses of $6,422,000 for the six-month period ended June 30, 2008 compared to a provision for loan losses of $260,000 for the same period in 2007. The increase in the provision for loan losses during the six-month period in 2008 was primarily due to continued deterioration in collateral values and repayment abilities of some of the Bank's customers centered in the Company's residential construction and construction related commercial segment of the loan portfolio affected by the repercussions of the country's housing market crisis.

- Total assets at June 30, 2008 were $661.4 million, a decrease of $31.7 million, or 4.6%, from prior-year first half levels.

- Total net loans at June 30, 2008 (including loans held-for-sale) increased $24.4 million, or 5.0%, to $513.4 million compared to June 30, 2007.

- Total investment securities at June 30, 2008 decreased $32.8 million, or 36.9%, to $56.1 million compared to June 30, 2007.

- Total deposits of $573.8 million at June 30, 2008, represented a decrease of $37.7 million, or 6.2%, compared to June 30, 2007. The primary reason for the decrease in deposits was due to the ongoing economic impact of the slowing real estate activity in the communities served by the Company. Since the peak in the real estate market, deposits in the real estate related business accounts show consistent reduction in average and end of period balances while the number of customers has remained stable.

- Net loss for the quarter of $0.86 million, down 143.2% from the $1.99 million earned in the second quarter of 2007.
- Diluted (loss) per share for the quarter of ($0.10) compared to $0.22 income per diluted share earned a year ago.

SUMMARY

The Company recorded a net loss of $864,000 for the three-month period ended June 30, 2008, representing a decrease of $2,849,000 or 143.5% from net income of $1,985,000 for the same period in 2007.

The Company recorded a net loss of $804,000 for the six-month period ended June 30, 2008, representing a decrease of $4,879,000 or 119.7% from net income of $4,075,000 for the same period in 2007.

The following table presents a summary of the results for the three-month and six-month periods ended June 30, 2008 and 2007.

	(in thousands, except per share and percentage amounts)			
.	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
For the Period:				
Net (Loss) Income	$ (864)	$ 1,985	$ (804)	$ 4,075
Basic (Loss) Earnings Per Share*	$ (0.10)	$ 0.22	$ (0.09)	$ 0.46
Diluted (Loss) Earnings Per Share*	$ (0.10)	$ 0.22	$ (0.09)	$ 0.44
At Period End:				
Total Assets	$ 661,375	$ 693,109	$ 661,375	$ 693,109
Total Loans, Net (including loans held-for-sale)	$ 513,383	$ 488,987	$ 513,383	$ 488,987
Total Investment Securities	$ 56,053	$ 88,889	$ 56,053	$ 88,889
Total Deposits	$ 573,775	$ 611,547	$ 573,775	$ 611,547
Loan-To-Deposit Ratio	89.5%	80.0%	89.5%	80.0%%

*Adjusted for stock dividends

Distribution of Average Statements of Condition and Analysis of Net Interest Income
(in thousands, except percentage amounts)

	Three months ended June 30, 2008			Three months ended June 30, 2007		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets						
Interest-earning assets:						
Loans (1)	$ 505,182	$ 8,540	6.78%	$ 477,140	$ 10,379	8.72%
Federal funds sold	23,876	127	2.13%	76,081	992	5.23%
Interest bearing due from banks	16,571	144	3.49%	—	—	—
Investment securities, taxable	28,043	342	4.89%	55,449	684	4.95%
Investment securities, non-taxable (2)	31,649	328	4.16%	28,051	302	4.32%
Other interest earning assets	2,241	37	6.62%	2,134	31	5.83%
Total interest-earning assets	607,562	9,518	6.28%	638,855	12,388	7.78%
Non-interest-earning assets:						
Cash and due from banks	22,853			24,355		
Premises and equipment, net	7,978			8,210		
Other real estate owned	3,407			1,380		
Accrued interest receivable and other assets	24,981			22,561		
Total average assets	666,781			695,361		
Liabilities and Stockholders' Equity:						
Interest-bearing liabilities:						
Interest-bearing transaction deposits	132,311	226	0.69%	130,657	777	2.39%
Savings and MMDA's	174,489	429	0.99%	184,474	1,143	2.49%
Time, under $100,000	43,073	252	2.35%	46,042	383	3.34%
Time, $100,000 and over	67,713	534	3.16%	73,424	795	4.34%
FHLB advances and other borrowings	9,093	61	2.69%	10,526	89	3.39%
Total interest-bearing liabilities	426,679	1,502	1.41%	445,123	3,187	2.87%
Non-interest-bearing liabilities:						
Non-interest-bearing demand deposits	171,308			180,816		
Accrued interest payable and other liabilities	5,615			6,577		
Total liabilities	603,602			632,516		
Total stockholders' equity	63,179			62,845		
Total average liabilities and stockholders' equity	$ 666,781			$ 695,361		
Net interest income and net interest margin (3)		$ 8,016	5.29%		$ 9,201	5.78%

1. Average balances for loans include loans held-for-sale and non-accrual loans and are net of the allowance for loan losses, but non-

accrued interest thereon is excluded. Loan interest income includes loan fees of approximately $382 and $603 for the three months
ended June 30, 2008 and 2007, respectively.
2. Interest income and yields on tax-exempt securities are not presented on a taxable equivalent basis.
3. Net interest margin is computed by dividing net interest income by total average interest-earning assets.

Distribution of Average Statements of Condition and Analysis of Net Interest Income
(in thousands, except percentage amounts)

	Six months ended June 30, 2008			Six months ended June 30, 2007		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets						
Interest-earning assets:						
Loans (1)	$ 496,484	$ 17,780	7.18%	$ 477,584	$ 20,754	8.76%
Federal funds sold	31,533	417	2.65%	71,583	1,852	5.22%
Interest bearing due from banks	19,690	412	4.20%	—	—	
Investment securities, taxable	34,356	840	4.90%	54,441	1,334	4.94%
Investment securities, non-taxable (2)	32,990	686	4.17%	26,927	580	4.34%
Other interest earning assets	2					