

**FIRST BUSINESS BANK N.A.**  
**ANNUAL REPORT 2007**



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## TO OUR SHAREHOLDERS

In February 2008, First Business Bank commemorated the opening of our corporate headquarters and new office in Del Mar Heights. This event provided us with the opportunity to celebrate our achievements over the past year and commence 2008 with a focused and definitive strategy for growth.

### 2007 MILESTONES



2007 was a challenging year; however, we were fortunate to achieve many positive milestones that reinforced First Business Bank's strength as a growing San Diego community business bank.

The Bank completed a name change from Ramona National Bank to First Business Bank. The change allowed the Bank to focus on our primary target market of business and professional clients in San Diego County. Conversion to our new name and logo was completed in the beginning of 2007 and contributed to the success we enjoyed during the year.

We were very fortunate to welcome many new, talented associates to the Bank. Notably, we attracted Sharon Fraher as Senior Vice President and Chief Administrative Officer of First Business Bank. Her expertise, coupled with that of the talents and experience of other new associates, has been very valuable in expanding our operations department, improving client services, and attracting strong client relationships.

With our continued focus on business banking, we have been diligent in the creation of a strong cash management and financing product mix for our customers. In July 2007, we introduced state-of-the-art online banking technology to our business and retail clients. Later in the year, we launched *Express Deposit*, a remote deposit service that allows a client to make deposits from the convenience of their office.

### FINANCIAL HIGHLIGHTS

For the year 2007:

- The Bank's assets grew to \$73.1 million, up from \$65.2 million a year ago, an increase of 12%.
- Loans increased more than 45%, from \$32.2 million to \$46.7 million.
- Deposits increased to \$49.5 million, up 18% from last year.
- The Bank's net loss improved by \$1.3 million in 2007 to a loss of \$269 thousand.

## LOOKING AHEAD TO 2008

As we begin 2008, First Business Bank is proud to announce that the Comptroller of the Currency has notified the Board of Directors that the Consent Order dated December 14, 2005, has been terminated effective March 26, 2008.

Since the Order was first issued, the Bank and its Board undertook a number of sweeping changes that successfully turned around the company and paved the way for the order to be lifted. The Bank:

- Hired an entire new senior management team
- Raised \$18,000,000 in new capital
- Changed our name to First Business Bank, N.A., and redirected our strategy and marketing efforts toward the business and professional community of San Diego County
- Successfully launched a new logo and marketing campaign
- Relocated our headquarters to Del Mar Heights, and expanded to three office locations

Under new leadership, 2008 will be an exciting year for the Bank. On March 26, 2008, Nathan L. Rogge was elected President and Chief Executive Officer of First Business Bank. Previously, Mr. Rogge served as Executive Vice President and Chief Operating Officer of the Bank.

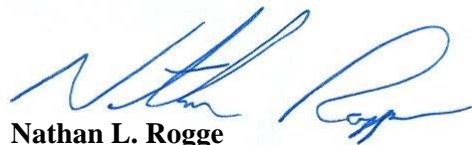
At the same time, John F. McGrath concluded his exemplary service as President and Chief Executive Officer from 2006 to 2008. Mr. McGrath was instrumental in leading the dramatic improvement that led to the release of the Consent Order and the overall success of First Business Bank during his tenure. He will continue to serve on the Board of Directors.

We are also excited to welcome Thomas H. Blair, Jr., to the Board of Directors. Mr. Blair is the editor-in-chief of *San Diego Magazine* and is well known in the San Diego community, having served on the boards of more than a dozen charitable organizations and foundations, including The Monarch School for Homeless Children, Scripps Cancer Center and The San Diego Film Commission.

We are committed to growth, focus, execution and outstanding client service. We are grateful to our employees, clients, directors and shareholders for their continued support.



**John Farkash**  
Chairman of the Board of Directors



**Nathan L. Rogge**  
President and Chief Executive Officer



Vavrinek, Trine, Day & Co., LLP  
Certified Public Accountants & Consultants

VALUE THE DIFFERENCE

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
First Business Bank N.A.  
Del Mar, California

We have audited the accompanying statement of financial condition of First Business Bank N.A. as of December 31, 2007, and the related statement of operations, shareholder's equity, and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit. The statements of First Business Bank N.A. as of December 31, 2006 were audited by other auditors whose report dated March 17, 2007 expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Business Bank N.A. as of December 31, 2007 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Vavrinek, Trine, Day & Co., LLP*

Laguna Hills, California  
April 1, 2008

**First Business Bank, N.A.**

**STATEMENTS OF FINANCIAL CONDITION  
December 31, 2007 and 2006**

**ASSETS**

	2007	2006
Cash and Due from Banks	\$ 1,029,992	\$ 2,234,719
Federal Funds Sold	8,051,889	8,233,048
<b>TOTAL CASH AND CASH EQUIVALENTS</b>	<b>9,081,881</b>	<b>10,467,767</b>
Interest-Bearing Time Deposits in Financial Institutions	2,503,217	12,937,767
Investment Securities Available for Sale	11,759,020	7,616,068
Loans Held for Sale	1,050,517	-
Loans:		
Construction and Land Development	3,138,731	4,870,021
Real Estate - Other	30,692,412	17,373,690
Commercial	10,997,902	9,559,761
Consumer	1,778,385	1,626,150
<b>TOTAL LOANS</b>	<b>46,607,430</b>	<b>33,429,622</b>
Deferred Loan Fees, Net of Costs	( 164,973)	( 43,437)
Discount on SBA Loans	( 98,395)	( 59,155)
Allowance for Loan Losses	( 676,017)	( 1,088,905)
<b>NET LOANS</b>	<b>45,668,045</b>	<b>32,238,125</b>
Stock Investments, at Cost	959,250	878,450
Premises and Equipment	1,159,745	354,233
Accrued Interest and Other Assets	953,317	670,287
<b>TOTAL ASSETS</b>	<b>\$ 73,134,992</b>	<b>\$ 65,162,697</b>

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

**First Business Bank, N.A.**

**STATEMENTS OF FINANCIAL CONDITION  
December 31, 2007 and 2006**

**LIABILITIES AND SHAREHOLDERS' EQUITY**

	2007	2006
Deposits:		
Noninterest-Bearing Demand	\$ 8,405,730	\$ 8,433,775
Interest-Bearing Demand, Money Market and Savings Accounts	31,757,342	24,939,046
Time Deposits Under \$100,000	3,169,708	4,546,659
Time Deposits \$100,000 and Over	6,181,715	4,088,718
<b>TOTAL DEPOSITS</b>	<b>49,514,495</b>	<b>42,008,198</b>
Accrued Interest and Other Liabilities	983,673	438,184
<b>TOTAL LIABILITIES</b>	<b>50,498,168</b>	<b>42,446,382</b>
Commitments and Contingencies - Note E and K	-	-
Shareholders' Equity:		
Common Stock - 10,000,000 Shares Authorized, No Par Value;		
Issued and Outstanding 2,642,534 in 2007 and 2,641,534 in 2006	13,212,670	13,207,670
Additional Paid-in Capital	13,256,476	13,157,036
Accumulated Deficit	( 3,904,775)	( 3,636,101)
Accumulated Other Comprehensive Income - Unrealized Gain		
(Loss) on Available-for-Sale Securities	72,453	( 12,290)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>22,636,824</b>	<b>22,716,315</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 73,134,992</b>	<b>\$ 65,162,697</b>

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

**First Business Bank, N.A.**

**STATEMENTS OF OPERATIONS  
December 31, 2007 and 2006**

	2007	2006
<b>INTEREST INCOME</b>		
Interest and Fees on Loans	\$ 3,621,949	\$ 2,760,519
Investment Securities:		
Interest Income	415,559	89,675
Dividends	55,002	22,364
Interest on Federal Funds Sold	499,130	306,515
Interest on Time Deposits in Financial Institutions	321,320	593,329
<b>TOTAL INTEREST INCOME</b>	<b>4,912,960</b>	<b>3,772,402</b>
 <b>INTEREST EXPENSE</b>		
Interest on Savings, NOW and Money Market Accounts	1,092,138	773,908
Interest on Time Deposits	326,118	484,885
<b>TOTAL INTEREST EXPENSE</b>	<b>1,418,256</b>	<b>1,258,793</b>
<b>NET INTEREST INCOME</b>	<b>3,494,704</b>	<b>2,513,609</b>
 Provision for Loan Losses	-	524,392
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>3,494,704</b>	<b>1,989,217</b>
 <b>NONINTEREST INCOME</b>		
Service Charges, Fees and Other	233,926	269,841
Gain on Sale of Loans	294,909	-
Loan Referral Fees	274,138	24,000
	<b>802,973</b>	<b>293,841</b>
 <b>NONINTEREST EXPENSE</b>		
Salaries and Employee Benefits	2,613,124	2,297,675
Occupancy and Equipment Expenses	499,895	361,716
Other Expenses	1,452,532	1,213,014
	<b>4,565,551</b>	<b>3,872,405</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>( 267,874)</b>	<b>( 1,589,347)</b>
Income Taxes	800	800
<b>NET LOSS</b>	<b>\$ ( 268,674)</b>	<b>\$ ( 1,590,147)</b>
<b>NET LOSS PER SHARE - BASIC</b>	<b>\$ ( 0.10)</b>	<b>\$ ( 1.15)</b>

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

**First Business Bank, N.A.**

**STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
December 31, 2007 and 2006**

	Shares Outstanding	Common Stock	Additional Paid-in Capital	Comprehensive Income	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
<b>Balance at January 1, 2006</b>	836,634	\$ 4,183,170	\$ 4,080,032		\$( 2,045,954)	\$( 21,444)	\$ 6,195,804
Issuance of Stock, net of expense	1,787,400	8,937,000	8,933,230				17,870,230
Exercise of Stock Options	17,500	87,500	87,875				175,375
Stock-Based Compensation			55,899				55,899
<b>Comprehensive Income:</b>							
Net Loss				\$( 1,590,147)	( 1,590,147)		( 1,590,147)
Unrealized Gain on Available-for-Sale Securities				9,154		9,154	9,154
<b>Total Comprehensive Income</b>				<u>\$( 1,580,993)</u>			
<b>Balance at December 31, 2006</b>	2,641,534	13,207,670	13,157,036		( 3,636,101)	( 12,290)	22,716,315
Exercise of Stock Options	1,000	5,000	5,000				10,000
Stock-Based Compensation			94,440				94,440
<b>Comprehensive Income:</b>							
Net Loss				\$( 268,674)	( 268,674)		( 268,674)
Unrealized Gain on Available-for-Sale Securities				84,743		84,743	84,743
<b>Total Comprehensive Income</b>				<u>\$( 183,931)</u>			
<b>Balance at December 31, 2007</b>	<u>2,642,534</u>	<u>\$ 13,212,670</u>	<u>\$ 13,256,476</u>		<u>(\$ 3,904,775)</u>	<u>\$ 72,453</u>	<u>\$ 22,636,824</u>

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

**First Business Bank, N.A.**

**STATEMENTS OF CASH FLOWS**  
**December 31, 2007 and 2006**

	2007	2006
<b>OPERATING ACTIVITIES</b>		
Net Loss	\$( 268,674)	\$( 1,590,147)
Adjustments to Reconcile Net Loss to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization	152,655	140,546
Gain on Sale of SBA loans	( 294,909)	-
Provision for Loan Losses	-	524,392
Provision for Losses on Unfunded Loan Commitments	-	25,000
Stock-Based Compensation	94,440	55,899
Amortization of Net Premiums on Investments	4,019	2,152
Amortization of Servicing Assets	14,538	7,479
Accretion of loan discounts and deferred interest, net of loan origination costs and fees deferred	( 106,702)	22,849
FHLB Stock Dividends paid in FHLB Stock	( 8,300)	( 5,300)
Loss on Disposal of Premises and Equipment	7,979	-
Proceeds from Sale of Loans	5,742,840	-
Loans Originated for Sale	( 1,051,993)	-
Increase in Other Assets	( 247,484)	( 285,842)
Increase in Other Liabilities	204,568	196,315
<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<b>4,242,977</b>	<b>( 906,657)</b>
<b>INVESTING ACTIVITIES</b>		
Purchase of Available-for-Sale Securities	( 8,374,413)	( 6,746,482)
Purchase of Loans Held for Investment	( 500,000)	( 1,257,178)
Net (Purchase) Maturity of Time Deposits in Financial Institutions	10,434,550	( 4,239,097)
Proceeds from Maturities of Available-for-Sale Securities	4,320,378	211,998
Net (Funding) Repayment of Loans	( 18,310,528)	2,108,477
Purchase of Federal Home Loan and Federal Reserve Bank Stock	( 72,500)	( 520,400)
Purchases of Premises and Equipment	( 642,646)	( 23,694)
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>( 13,145,159)</b>	<b>( 10,466,376)</b>

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

**First Business Bank, N.A.**

**STATEMENTS OF CASH FLOWS - Continued**  
**December 31, 2007 and 2006**

**FINANCING ACTIVITIES**

Net Increase in Demand, MMDA and Savings accounts	6,790,250	5,242,152
Net Increase (Decrease) in Time Deposits	716,046	( 5,562,953)
Proceeds from Exercise of Stock Options	10,000	175,375
Net Proceeds from Issuance of Common Stock	-	17,870,230
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>7,516,296</b>	<b>17,724,804</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>( 1,385,886)</b>	<b>6,351,771</b>
Cash and Cash Equivalents at Beginning of Period	10,467,767	4,115,996
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 9,081,881</b>	<b>\$ 10,467,767</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Interest Paid	\$ 1,429,241	\$ 1,257,074
Taxes Paid	\$ 800	\$ 800
Loans transferred from Held for Investment to Held for Sale	\$ 5,401,554	\$ -
Loans transferred from Held for Sale to Held for Investment	\$ -	\$ 199,327
Leasehold Improvements Paid for by the Landlord	\$ 323,500	\$ -
Change in unrealized Gain (Loss) on AFS Investments, net of change in Income Tax of \$8,191 and \$7,233, recorded in AOCI	\$ 84,743	\$ 9,154

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

**First Business Bank, N.A.**

**NOTES TO FINANCIAL STATEMENTS  
December 31, 2007 and 2006**

**NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations

First Business Bank N.A. began business operations in December 2001 under the name Ramona National Bank. The name was changed in late 2006. The Bank operates under a federal charter and its primary regulator is the Office of the Comptroller of the Currency (“OCC”). First Business Bank is organized as a single operating segment that operates three full-service offices in Del Mar, La Mesa, and Ramona, California. The Bank's primary source of revenue is providing loans to clients, who are predominately small and middle-market businesses and individuals. Client deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to the maximum legal limit and the Bank is a member of the Federal Reserve Bank (“FRB”).

Use of Estimates in the Preparation of Financial Statements

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

Reclassifications

Certain amounts in the 2006 financial statements have been reclassified to conform to the 2007 presentation. The reclassifications have no effect on net loss or shareholders equity as previously reported.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, and federal funds sold. Generally, federal funds are sold for one-day periods.

Cash and Due from Banks

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's net transaction accounts were below the reserve exemption level at December 31, 2007 and 2006, and the Bank had no reserve requirement at either date.

The Bank maintains amounts due from banks, which may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Interest-Bearing Time Deposits in Financial Institutions

The Bank invests in time certificates of deposit at other financial institutions. The latest maturity of any of these deposits is July 2009.

Investment Securities

Investment securities are classified as held-to-maturity when the Bank has the positive intent and ability to hold the securities to maturity. Securities held-to-maturity is carried at amortized cost. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

**First Business Bank, N.A.**

**NOTES TO FINANCIAL STATEMENTS  
December 31, 2007 and 2006**

Investments not classified as trading securities nor as held-to-maturity securities are classified as available-for-sale securities and recorded at fair value. Unrealized gains or losses on available-for-sale securities are excluded from net income and reported as an amount net of taxes as a separate component of other comprehensive income included in shareholders' equity. Premiums or discounts on held-to-maturity and available-for-sale securities are amortized or accreted into income using the interest method. Realized gains or losses on sales of held-to-maturity or available-for-sale securities are recorded using the specific identification method.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other-than-temporary result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers; the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Stock Investments

Federal Reserve Bank stock, Federal Home Loan Bank stock and Pacific Coast Bankers' Bank stock are carried at cost. This stock can only be sold back to the issuing institution at par value. All stock investments are evaluated for impairment based on an estimate of the ultimate recoverability of cost.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs or specific valuation accounts and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Fair value is based on commitments on hand from investors or prevailing market prices. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. The Bank is a Small Business Administration (SBA) lender and will sell the guaranteed portion of the loan in the secondary market. SBA guaranteed loans are classified as Held for Sale when the loan is fully funded and other conditions required for salability have been met.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is past due 90 days based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectable as to all principal and interest.

The Bank considers a loan to be impaired when it is probable that the Bank will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are to be discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank selects the measurement method on a loan-by-loan basis except that

**First Business Bank, N.A.**

**NOTES TO FINANCIAL STATEMENTS  
December 31, 2007 and 2006**

collateral-dependent loans for which foreclosure is probable are measured at the net realizable value of the collateral. The Bank recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the loan is uncollectible. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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 Assets

Servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into other income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum

Gain on Sale of Loan

The Bank accounts for the sale of SBA guaranteed portions following Statement of Financial Accounting Standard ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," as amended by SFAS No. 156, "Accounting for Servicing of Financial Assets." The recorded investment in the guaranteed and unguaranteed portion of the loan, and separately identifiable servicing assets, is reallocated based on the relative fair values of each component. Accounting gain on sale is recognized to the extent the fair value of the assets sold and the servicing asset created exceed the reallocated recorded investment. Servicing assets are initially recorded at fair value. This reallocation of basis results in an accounting gain that is less than the cash premium received with the sale. The difference is recorded as a discount on the unguaranteed portion of the loan retained. The discount is accreted to income over the remaining life of the loan following the interest method.

**First Business Bank, N.A.**

**NOTES TO FINANCIAL STATEMENTS**

**December 31, 2007 and 2006**

Loan Referrals

The Bank may elect to refer loan clients to other lending institutions rather than close the transaction itself. These institutions will fund the loan directly and pay the Bank a referral fee for the transaction. The Bank has no credit recourse on these transactions. Limited recourse exists on the fee received, generally contingent on the loan's performance for ninety days after the transaction. Referral fees are recognized as earned in the period received. In 2007, the Bank referred loan transactions for \$5,330,000 in total principle balance to third party lenders for \$274,138 in referral fees. In 2006 the Bank referred loan transactions for \$600,000 in total principle balance for \$24,000 in referral fees.

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 ranges from three to seven years for furniture, equipment and computer equipment. 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.

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the consolidated financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforward periods.

The Bank has adopted Financial Accounting Standards Interpretation No. 48 ("Fin 48"), "*Accounting for Uncertainty in Income Taxes*." Fin 48 clarifies the accounting for uncertainty in tax positions taken or expected to be taken on a tax return and provides that the tax effects from an uncertain tax position can be recognized in the financial statements only if, based on its merits, the position is more likely than not to be sustained on audit by the taxing authorities. Management believes that all tax positions taken to date are highly certain and, accordingly, no accounting adjustment has been made to the financial statements. Interest and penalties related to uncertain tax positions are recorded as part of income tax expense.

Comprehensive Income

Statement of Financial Accounting Standard No. 130, "*Reporting Comprehensive Income*," requires the disclosure of comprehensive income and its components. Changes in unrealized gain and loss on available-for-sale securities are the only components of accumulated other comprehensive income for the Bank.

**First Business Bank, N.A.**

**NOTES TO FINANCIAL STATEMENTS**

**December 31, 2007 and 2006**

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 K. The Bank is a contingent obligor under a letter of credit issued on its behalf by another financial institution. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Disclosure about Fair Value of Financial Instruments

Other than the Bank's investment securities, no active market exists for the Bank's financial instruments. The fair market value of investment securities are discussed in Note B. Management believes the fair market value of its other financial instruments, primarily loans and deposits, approximates the amounts reported in the financial statements and notes.

Earnings 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 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 Bank had no dilutive securities as of December 31, 2007 and 2006 as well as an operating loss and therefore only reports basic EPS. Weighted average shares outstanding used in the computation of basic earnings per share were 2,642,013 and 1,376,899 in 2007 and 2006, respectively.

Stock-Based Compensation

The Bank adopted SFAS No. 123(R) "*Shared-Based Payment*" effective January 1, 2006 following the modified prospective method. This Statement generally requires entities to recognize 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 which an employee is required to provide services in exchange for the award, generally the vesting period.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "*Fair Value Measurements*," effective for the Bank January 1, 2008. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy that distinguishes between valuations obtained from sources independent of the entity and those from the entity's own observable inputs that are not corroborated by observable market data. SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. The disclosures focus on the inputs used to measure fair value, and for recurring fair value measurements using significant unobservable inputs, the effect of the measurements on earnings or changes in net assets for the period. The Bank is currently assessing the impact of this guidance on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115.*" SFAS No. 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 are elective; however, the amendment to SFAS No. 115, "*Accounting for Certain Investments in Debt and Equity*

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*Securities,*” applies to all entities with available-for-sale or trading securities. For financial instruments elected to be accounted for at fair value, an entity will report the unrealized gains and losses in earnings. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Bank is currently assessing the financial impact this Statement will have on the statement of financial condition or results of operations.

**NOTE B - INVESTMENT SECURITIES**

Debt and equity securities have been classified in the statements of condition according to management’s intent. The carrying amount of securities and their approximate fair values at December 31 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available-for-Sale:</b>				
<b>December 31, 2007</b>				
U.S. Government and Agency Securities	\$ 5,995,935	\$ 44,247	\$( 6,300)	\$ 6,033,882
Mortgage-Backed Securities	<u>5,690,632</u>	<u>40,641</u>	<u>( 6,135)</u>	<u>5,725,138</u>
	<u>\$11,686,567</u>	<u>\$ 84,888</u>	<u>\$( 12,435)</u>	<u>\$11,759,020</u>
<b>Available-for-Sale:</b>				
<b>December 31, 2006</b>				
U.S. Government and Agency Securities	\$ 6,001,695	\$ 5,825	\$( 15,384)	\$ 5,992,136
Mortgage-Backed Securities	<u>1,634,855</u>	<u>6,344</u>	<u>( 17,267)</u>	<u>1,623,932</u>
	<u>\$ 7,636,550</u>	<u>\$ 12,169</u>	<u>\$( 32,651)</u>	<u>\$ 7,616,068</u>

The amortized cost and estimated fair value of all investment securities as of December 31, 2007 by contractual 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.

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**NOTES TO FINANCIAL STATEMENTS  
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	Available-for-Sale	
	Amortized Cost	Fair Value
Due in One Year or Less	\$ 7,578	\$ 7,549
Due from One Year to Five Years	6,167,907	6,201,805
Due from Five to Ten Years	71,996	69,939
Due after Ten Years	5,439,086	5,479,727
	<b>\$ 11,686,567</b>	<b>\$ 11,759,020</b>

There were no sales of investment securities in 2007 or 2006.

The Bank will pledge investment securities to collateralize credit lines, secure public deposits, and for other purposes as permitted or required by law. Investment securities carried at \$2,528,525 at December 31, 2007 were pledged against a purchased federal funds line with a correspondent bank. Investment securities carried at \$6,790,000 and \$6,674,000 at December 31, 2007 and 2006, respectively, were in safekeeping at the Federal Home Loan Bank (FHLB) of San Francisco to collateralize credit lines there.

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 at December 31, 2007 and 2006 are as follows:

	Less than Twelve Months		Over Twelve Months		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized losses	Fair Value
<b>December 31, 2007:</b>						
U.S. Government and Agencies	\$( 2,408)	\$ 1,497,592	\$( 3,892)	\$ 493,530	\$( 6,300)	\$ 1,991,122
Mortgage-Backed Securities	-	-	( 6,135)	245,411	( 6,135)	245,411
	<b>\$( 2,408)</b>	<b>\$ 1,497,592</b>	<b>\$( 10,027)</b>	<b>\$ 738,941</b>	<b>\$( 12,435)</b>	<b>\$ 2,236,533</b>
<b>December 31, 2006:</b>						
U.S. Government and Agencies	\$( 3,308)	\$ 3,507,471	\$( 12,076)	\$ 483,443	\$( 15,384)	\$ 3,990,914
Mortgage-Backed Securities	-	-	( 17,267)	458,685	( 17,267)	458,685
	<b>\$( 3,308)</b>	<b>\$ 3,507,471</b>	<b>\$( 29,343)</b>	<b>\$ 942,128</b>	<b>\$( 32,651)</b>	<b>\$ 4,449,599</b>

As of December 31, 2007, the Bank had three Agency securities where estimated fair value had declined 0.32% from the amortized cost, and five Mortgage-Backed securities that had declined 2.4% from amortized cost. Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Bank has the intent and ability to retain the investment for a period of time sufficient to allow for any anticipated

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recovery in fair value, which may be at maturity. As of December 31, 2007, no declines in value are deemed to be other-than-temporary.

**NOTE C - STOCK INVESTMENTS, at Cost**

As a member of the FRB System, the Bank must hold FRB stock in an amount equal to 6% of the Bank's common stock and additional paid-in capital, less accumulated deficit. Stock in the FHLB of San Francisco is required for membership. The Bank is required to maintain an investment in FHLB stock in an amount equal to the greater of 1% of its outstanding mortgage loans or 5% of advances from the FHLB. There were no advances from the FHLB as of December 31, 2007 or 2006. No ready market exists for FHLB stock, and it has no quoted market value.

The table below summarizes the Bank's stock investments at December 31:

	<u>2007</u>	<u>2006</u>
Federal Reserve Bank	\$ 682,950	\$ 699,250
Federal Home Loan Bank	216,300	119,200
Pacific Coast Bankers Bank	60,000	60,000
	<u>\$ 959,250</u>	<u>\$ 878,450</u>

**NOTE D - LOANS**

The Bank's loan portfolio consists primarily of loans to borrowers within San Diego 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. The Bank's loan portfolio concentration in real estate secured credit at December 31, 2007 was 73%.

The Bank is an SBA Preferred Lender and originates guaranteed loans under the SBA 7(a) program. In 2007, \$5,401,544 of guaranteed principal balances were sold. No sales of guaranteed loans were made in 2006. At December 31, 2007, the Bank's total SBA 7(a) portfolio was \$5,739,666. Total guaranteed balances were \$2,823,486, of which \$1,050,517 are classified as Held for Sale. The Bank's total servicing portfolio of sold guaranteed loans was \$7,021,252 at December 31, 2007 and \$1,313,075 at December 31, 2006. The recorded investment in servicing assets related to this portfolio was \$60,303 and \$23,380 at December 31, 2007 and 2006, respectively. Changes in the fair value of servicing assets subsequent to the initial recognition have been immaterial and the Bank had no impairment allowance for servicing assets at either balance sheet date.

The Bank has pledged loans with a carrying value of \$3,315,723 to collateralize credit lines at the FHLB of San Francisco as of December 31, 2007. The Bank had no loans pledged against credit lines at December 31, 2006.

A summary of the changes in the allowance for loan losses as of December 31 follows:

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**NOTES TO FINANCIAL STATEMENTS  
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	2007	2006
Beginning Balance	\$ 1,088,905	\$ 572,330
Additions to the Allowance Charged to Expense	-	524,392
Recoveries on Loans Charged Off	787	267
	1,089,692	1,096,989
Less Loans Charged Off	( 413,675)	( 8,084)
Ending Balance	\$ 676,017	\$ 1,088,905

Below is a summary the Bank's recorded investment in impaired loans outstanding at December 31, 2007 and 2006.

	2007	2006
Recorded Investment in Impaired Loans with Reserves	\$ 1,024,389	\$ 1,163,009
Recorded Investment in Impaired Loans without Reserves	-	-
	\$ 1,024,389	\$ 1,163,009
Related Allowance for Loan Losses	\$ 82,838	\$ 455,669

No additional funds are committed to be advanced on impaired loans. The average recorded investment in impaired loans was \$1,030,684 and \$323,463 in 2007 and 2006, respectively. The Bank recognized \$102,924 in interest income on impaired loans in 2007. No interest income on impaired loans was recognized in 2006. Interest foregone on impaired loans was \$54,436 in 2007 and \$31,439 in 2006. At December 31, 2007, \$610,199 in principal balance of impaired loans was guaranteed by the SBA, and none of the principal balance of impaired loans was guaranteed by the SBA at December 31, 2006.

In addition to servicing sold SBA guaranteed loans, the Bank also services construction loans and commercial lines of credit for participating institutions. The total portfolio of loans serviced for other institutions was \$1,984,587 at December 31, 2007 and \$1,482,727 at December 31, 2006.

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**NOTES TO FINANCIAL STATEMENTS  
December 31, 2007 and 2006**

**NOTE E - PREMISES AND EQUIPMENT**

A summary of premises and equipment as of December 31 follows:

	<u>2007</u>	<u>2006</u>
Leasehold Improvements	\$ 1,006,939	\$ 330,623
Furniture, Fixtures, and Equipment	529,857	358,763
Computer Equipment	<u>266,292</u>	<u>167,420</u>
	1,803,088	856,806
Less Accumulated Depreciation and Amortization	<u>( 643,343)</u>	<u>( 502,573)</u>
	<u>\$ 1,159,745</u>	<u>\$ 354,233</u>

Depreciation expense recorded in 2007 and 2006 was \$152,655 and \$140,546, respectively.

The Bank leases its Ramona banking premises from its principal shareholder, under a lease expiring on August 31, 2010. The Bank obtained three independent appraisals regarding the fair market rent, which supports its determination that the terms of the lease are no less favorable to the Bank than could have been obtained from unaffiliated third parties. The Ramona branch lease has two five year renewal options. Monthly lease payments are adjusted annually based on changes in the Consumer Price Index (CPI).

The Bank leases its La Mesa location from an affiliate of its principal shareholder. This lease expires on February 28, 2010. The Bank obtained an independent review regarding the fair market rent to support its determination that the terms of the lease are no less favorable to the Bank than could have been obtained from unaffiliated third parties. Lease payments are adjusted annually based on changes in the CPI. The lease on the La Mesa office holds three five year renewal options.

The Bank has entered into a ten-year lease for its new main banking office and administrative offices in Del Mar, California, with an independent landlord. At December 31, 2007, the tenant improvements were being completed and the Bank took occupancy in January 2008. Total expenditures for tenant improvements, equipment and furnishings at the Del Mar location through December 31, 2007 were approximately \$792,000, including \$2,390 in interest capitalized at the Bank's cost of funds. The Bank expects the total expenditures for tenant improvements, equipment and furnishings at this office at final completion to be approximately \$935,000. The Bank is responsible for common area maintenance, taxes and insurance to the extent they exceed the base year amounts. The lease expires on December 31, 2017. Monthly lease payments are subject to a fixed 3.5% increase on an annual basis. The lease has one renewal option for a period of five years. A third party correspondent bank issued a performance letter of credit for \$775,000 to the landlord on behalf of the Bank to support the Bank's obligations under the lease. The lease allows for annual reductions in the amount of the letter of credit after three years and eliminates the letter of credit entirely after nine years.

At December 31, 2007, the future lease rentals payable under noncancellable operating lease commitments to related parties and others are as follows:

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**NOTES TO FINANCIAL STATEMENTS  
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	<u>Related Party</u>	<u>Others</u>
2008	\$ 133,027	\$ 310,320
2009	133,027	321,181
2010	51,640	332,042
2011	-	343,679
2012	-	356,092
Thereafter	-	1,976,738
	<u>\$ 317,694</u>	<u>\$ 3,640,052</u>

The minimum rental payments shown above are given for the existing lease obligation and are not a forecast of future rental expense. Total rental expense was \$241,524 and \$113,658 for the years ended December 31, 2007 and 2006, respectively.

**NOTE F - DEPOSITS**

At December 31, 2007, the scheduled maturities of time deposits are as follows:

2008	\$ 7,363,525
2009	1,328,005
2010	516,754
2011	<u>143,139</u>
	<u>\$ 9,351,423</u>

As of December 31, 2007 the Bank had seven deposit relationships that exceed 2% of total deposits and aggregated approximately \$7,091,000.

**NOTE G - BORROWING ARRANGEMENTS**

The Bank may borrow up to \$6,000,000 overnight on an unsecured basis from The Independent BankersBank, and \$2,000,000 overnight on a secured basis from Pacific Coast Bankers Bank. The Bank had no overnight borrowings at December 31, 2007.

The Bank may also borrow up to approximately \$10,300,000 from the Federal Home Loan Bank of San Francisco, collateralized by investment securities and liens on specific Bank loans delivered to the FHLB, and subject to fulfilling other conditions of the credit facility. As of December 31, 2007, a Letter of Credit issued by the FHLB on the Bank's behalf for \$775,000 was outstanding under the facility.

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**NOTES TO FINANCIAL STATEMENTS**

**December 31, 2007 and 2006**

**NOTE H - INCOME TAXES**

The tax expense for the years ended December 31, 2007 and 2006 was the minimum franchise tax for the State of California. The tax benefits related to the operating losses incurred during the years ended December 31, 2007 and 2006 were not recognized, as realization of the benefits is dependent upon future income.

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

	2007	2006
Deferred Tax Assets:		
Depreciation Differences	\$ 66,000	\$ 48,000
Allowance for Loan Losses Due to Tax Limitations	238,000	448,000
Stock-Based Compensation	19,000	-
Operating Loss Carryforwards	1,248,000	1,130,000
Other	75,000	37,000
	1,646,000	1,663,000
 Valuation Allowance	 ( 1,565,000)	 ( 1,497,000)
Deferred Tax Liabilities:		
Deferred Loan Costs	( 14,000)	-
Accrual to Cash	( 67,000)	( 166,000)
	( 81,000)	( 166,000)
 Net Deferred Tax Assets	 \$ -	 \$ -

The valuation allowance was established because the Bank has not reported earnings sufficient enough to support the recognition of the deferred tax assets. The Bank has net operating loss carryforwards of approximately \$3,028,000 for federal income and \$3,055,000 for California franchise tax purposes. Federal net operating loss carryforwards, to the extent not used will expire in 2027. California net operating loss carryforwards, to the extent not used will expire in 2017.

The Bank is subject to federal and California franchise tax. Income tax returns for the years ended December 31, 2006, 2005 and 2004 are open to audit by the federal authorities and income tax returns for the years ended December 31, 2006, 2005, 2004 and 2003 are open to audit by California authorities. Unrecognized tax benefits are not expected to significantly increase or decrease within the next twelve months.

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**NOTES TO FINANCIAL STATEMENTS  
December 31, 2007 and 2006**

**NOTE I - OTHER EXPENSES**

Other expenses as of December 31 are comprised of the following:

	<u>2007</u>	<u>2006</u>
Data Processing	\$ 330,376	\$ 272,114
Marketing and Business Promotion	74,577	73,337
Professional Fees	407,152	420,332
Office Expenses	139,106	82,000
Insurance	39,904	36,864
Deposit Administration and Online Banking	75,425	62,207
Loan Administration	63,454	37,009
Regulatory Assessments	109,841	54,829
Other Expenses	212,697	174,322
	<u>\$ 1,452,532</u>	<u>\$ 1,213,014</u>

**NOTE J - 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. In the Bank's opinion, all loans and loan commitments to such parties are made on substantially the same terms including interest rates, and collateral, as those prevailing at the time for comparable transactions with unrelated clients. The balance of these loans outstanding was \$498,585 and \$514,938 at December 31, 2007 and 2006, respectively. Activity in related party loans for the periods ending December 31, 2007 and 2006 is below:

	<u>2007</u>	<u>2006</u>
Balance at Beginning of Year	\$ 514,938	\$ 545,550
Credit Granted, Including Renewals	\$ 68,000	\$ 36,054
Repayments	<u>(84,353)</u>	<u>(66,666)</u>
	<u>\$ 498,585</u>	<u>\$ 514,938</u>

Deposits held by the Bank from certain shareholders, directors, officers and their related interests at December 31, 2007 and 2006 amounted to \$3,544,524 and \$7,620,673, respectively.

**NOTE K – COMMITMENTS & CONTINGENCIES**

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.

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Commitments to extend credit are agreements to lend to a client 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.

The Bank's exposure to loan loss in the event of nonperformance 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, 2007 and 2006, the Bank had the following outstanding financial commitments whose contractual amount represents potential credit risk to the Bank, and potential financial obligations of the Bank:

	<u>2007</u>	<u>2006</u>
Commitments to Extend Credit	\$ 12,331,000	\$ 5,856,000
Letters of Credit issued to Clients	<u>-</u>	<u>244,000</u>
	<u>\$ 12,331,000</u>	<u>\$ 6,100,000</u>
Letters of Credit issued on behalf of the Bank	<u>\$ 775,000</u>	<u>\$ -</u>

The Bank carries a reserve for potential credit risk on unfunded commitments to extend credit in other liabilities. The balance of the reserve at December 31, 2007 and 2006 was \$30,000. The Bank evaluates this reserve following the same principles used for the allowance for loan losses, with consideration for experienced utilization rates on client credit lines and the inherently lower risk of unfunded commitments relative to disbursed commitments.

Letters of Credit issued on behalf of the Bank represent a potential obligation of the Bank. The Bank caused a letter of credit to be issued by a third party correspondent to its landlord at the Del Mar office. Should the letter of credit be drawn upon, the Bank would be obligated to reimburse the correspondent bank. The letter of credit supports the Bank's performance of its duties under the lease.

In the ordinary course of business the Bank may be subject to legal claims by clients and other business constituents. The Bank has been served with a legal complaint by a former information technology vendor alleging breach of contract and seeking damages of approximately \$610,000. Based on the facts of the case, should the plaintiff prevail at trial, the Bank believes it reasonably possible that damages in the range of \$120,000 to \$130,000 could be awarded. The Bank intends to defend itself vigorously in this matter.

**NOTE L - STOCK OPTION PLAN**

The Bank's 2001 Stock Option Plan (the "Plan") was modified by its shareholders in April 2007. The maximum number of shares that may be awarded to eligible employees and directors was increased from 210,000 shares to 460,000 shares. Under the terms of the Plan, officers and key employees may be granted either nonqualified or incentive stock options. Directors, who are not also an officer or employee, may be granted nonqualified stock options. Stock options are generally 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 generally vest over five years. The Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. Shares

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issued for the exercise of stock options are made from available authorized but unissued shares. The Bank recognized stock-based compensation cost of \$94,440 and \$55,899 in 2007 and 2006, respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following table provides the weighted average assumptions used in the pricing model, and the weighted average grant date fair value, for option grants made in 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Expected Volatility	24.96%	15.52%
Expected Term (Years)	6.1	6
Expected Dividends	None	None
Risk Free Rate	3.89%	5.11%
Weighted-Average Grant Date Fair Value	\$ 3.36	\$ 3.10

Since the Bank has very limited historical stock trade volume, the expected volatility is based on an index of the historical volatility of similar banks that have a longer trading history at higher volumes. 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 yield on U.S. Treasury bonds with maturities comparable to 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, 2007 and changes during 2007 is presented below:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value in Thousands</u>
Outstanding at Beginning of Year	134,302	\$ 10.00		
Granted	112,075	\$ 10.00		
Exercised	(1,000)	\$ 10.00		
Forfeited or Expired	<u>(16,700)</u>	\$ 10.02		
Outstanding at End of Year	<u>228,677</u>	<u>\$ 10.00</u>	<u>8.3 Years</u>	<u>None</u>
Options Exercisable	<u>134,905</u>	<u>\$ 10.00</u>	<u>6.3 Years</u>	<u>None</u>
Options Available for Grant	<u>212,323</u>			

The intrinsic value of options exercised during the years ended December 31, 2007 and 2006 was immaterial.

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**NOTES TO FINANCIAL STATEMENTS  
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As of December 31, 2007, there was \$484,908 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted average period of approximately 2.7 years as scheduled below:

Expected pre-tax compensation cost:

2008	\$	116,967
2009		119,975
2010		113,938
2011		83,483
2012		50,545
		<hr/>
	\$	484,908
		<hr/> <hr/>

Future levels of compensation cost recognized related to stock-based compensation awards may be impacted by new awards and/or modifications, repurchases and cancellations of existing awards. During 2007 the Bank made a special nonqualified option grant to the Chief Operating Officer for 15,000 shares. This grant was made in recognition of past service and vested immediately, resulting in \$43,703 of stock-based compensation expense. Under the terms of the Plan, vested options expire ninety days after the director or employee terminates the service affiliation with the Bank. In 2007, vested grants for a total of 26,500 shares to four retiring directors were modified and the expiration provisions with the termination of service were waived.

**NOTE M - REGULATORY MATTERS**

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined).

As of December 31, 2007, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as "adequately capitalized" under the regulatory framework for prompt corrective action. As of December 31, 2007, the Bank's capital level and ratios indicate that it is "well capitalized" under the regulatory framework for prompt corrective action. However, the OCC categorized the Bank as "adequately capitalized" due to the Bank operating under an OCC consent order, effective December 14, 2005 (the "Consent Order"). In addition, the OCC consent order requires the Bank to maintain specific capital levels (discussed below).

To be categorized as well capitalized, the Bank must maintain minimum ratios as set forth in the table below. Management believes, as of December 31, 2007, that the Bank meets all capital adequacy requirements to which it is subject. The following table also sets forth the Bank's actual capital amounts and ratios (dollar amounts in thousands):

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**NOTES TO FINANCIAL STATEMENTS  
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	Amount of Capital Required					
	Actual		For Capital Adequacy Purposes		To Be Well- Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2007:</b>						
Total Capital (to Risk-Weighted Assets)	\$23,232	43.2%	\$ 4,304	8.0%	\$5,380	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$22,559	41.9%	\$ 2,152	4.0%	\$3,228	6.0%
Tier 1 Capital (to Average Assets)	\$22,559	31.3%	\$ 2,880	4.0%	\$3,599	5.0%
<b>As of December 31, 2006:</b>						
Total Capital (to Risk-Weighted Assets)	\$23,208	61.3%	\$ 3,030	8.0%	\$3,787	10.0%
Tier 1 Capital (to Risk-Weighted Assets)	\$22,727	60.0%	\$ 1,515	4.0%	\$2,272	6.0%
Tier 1 Capital (to Average Assets)	\$22,727	35.1%	\$ 2,589	4.0%	\$3,237	5.0%

Under federal law, a national bank generally may not pay cash dividends in excess of the bank's net profits, if it would impair the bank's capital, if the bank is in default on the payment of any assessment due to the FDIC, or if the bank has not paid all cumulative dividends on outstanding preferred stock. In addition, unless and until a bank's additional paid in capital account is equal to its common stock account, no dividend can be declared until the bank has carried to its additional paid-in capital account not less than one-tenth of its net profits for the preceding two consecutive half-years (in the case of annual dividends). The Bank cannot legally pay dividends at this time and the Bank intends to follow a policy of retaining earnings, if any, for the purpose of increasing its net worth and reserves. Accordingly, the Bank does not anticipate that cash dividends will be declared for several years and no assurance can be given that its earnings will permit the payment of dividends of any kind.

Effective December 14, 2005, the Bank executed a Consent Order with the OCC pursuant to the authority vested in it by the Federal Deposit Insurance Act, as amended, 12 U.S.C. § 1818. The Consent Order requires, among other actions, that the Bank (a) appoint a Compliance Committee that is responsible for monitoring the Bank's adherence to the provisions of the Consent Order; (b) appoint an experienced Chief Executive Officer; (c) retain qualified and experienced management and notify the OCC of any proposed additions to or resignations from the Board or senior management; (d) maintain a Tier 1 Capital Ratio of at least 9.0%, and a Total Capital to Risk-Weighted Assets Ratio of at least 12.0%; (e) develop and implement a written program to improve the Bank's loan portfolio management process; (f) refrain from extending any additional credit whatsoever for construction or land purposes until the Bank has developed and implemented a written program to improve its construction and land loan underwriting standards; (g) adopt and implement a written program to eliminate the basis of assets criticized by the OCC; (h) refrain from extending any additional credit to or for the benefit of any borrower who has a loan or other extension of credit from the Bank that has been criticized; (i) maintain an adequate allowance for loan losses; (j) correct apparent appraisal exceptions; and (k) file periodic progress reports with the OCC.

The Bank's Tier 1 Capital Ratio was 31.3%, and the Total Capital to Risk-weighted Assets Ratio was 43.2%, as of December 31, 2007. Effective March 26, 2008, the Bank executed a Letter of Termination with the OCC, formally removing and terminating the Consent Order dated December 14, 2005.

**MISSION STATEMENT**

First Business Bank, N.A. is dedicated to serving the needs of individual, professional and business clients in San Diego County. We deliver a complete line of deposit and loan products designed to grow and nurture our banking relationships. We exceed our client, community and shareholder expectations.

**BOARD OF DIRECTORS**

**John Farkash** | Chairman of the Board

**Tom Blair** | Editor of San Diego Magazine

**William V. Ehlen** | President of Iron Horse Investments

**Lester Machado, MD, DDS, FRCS (Ed)** | Oral and Maxillofacial Surgeon

**John McGrath** | President of the Auerbach Trust

**Nathan L. Rogge** | President and C.E.O. of First Business Bank

**EXECUTIVE MANAGEMENT**

**Nathan L. Rogge** | President and Chief Executive Officer

**Paula J. Berggren** | Executive Vice President and Chief Credit Officer

**William T. Roche, III** | Executive Vice President and Chief Financial Officer

**Sharon Fraher** | Senior Vice President and Chief Administrative Officer

**LOCATIONS**

**DEL MAR**  
12265 El Camino Real, Suite 100  
San Diego, CA 92130  
Phone (858) 847-4700  
Fax (858) 847-4701  
Manager: Joseph Kight

**LA MESA**  
7966 La Mesa Boulevard  
La Mesa, CA 91941  
Phone (619) 464-5800  
Fax (619) 337-3622  
Manager: Aracely Scott

**RAMONA**  
1315 Main Street  
Ramona, CA 92065  
Phone (760) 788-8788  
Fax (760) 789-5576  
Manager: Melanie Hamilton

**ADDITIONAL INFORMATION**

**Stock Exchange Listing** | The common stock is listed on Over the Counter (“OTC”) trading as FBBK.PK.

**Market Maker** | Western Financial Services, Richard Levinson

**Professional Consultants**

Vavrinek Trine Day & Co., LLP  
Independent Accountants

Horgan, Rosen, Beckham & Coren,  
L.L.P.  
Legal Counsel

Lambert & Rogers  
Legal Counsel