First California Financial Group, Inc.
Form 10-Q
May 15, 2007
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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 March 31, 2007

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 000-52498

FIRST CALIFORNIA FINANCIAL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**38-3737811**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
1880 Century Park East, Suite 800	
Los Angeles, California	**90067**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (310) 277-2265

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

11,548,233 shares of Common Stock, $0.01 par value, as of April 16, 2007

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FIRST CALIFORNIA FINANCIAL GROUP, INC.

QUARTERLY REPORT ON

FORM 10-Q

For the Quarterly Period Ended March 31, 2007

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Condensed consolidated balance sheets

(in thousands, except share data)	**March 31, 2007**	**December 31, 2006**
Cash and due from banks	$ 26,433	$ 13,438
Federal funds sold	800	
Securities	182,220	104,414
Loans held for sale	25,583	
Loans, net	714,149	360,978
Premises and equipment, net	18,898	5,725
Goodwill	49,995	3,225
Core deposit and other intangibles	10,610	1,184
Cash surrender value of life insurance	10,620	
Accrued interest receivable and other assets	25,588	12,599
Total assets	$ 1,064,896	$ 501,563
Checking	$ 227,889	$ 115,745
Interest checking	43,056	26,372
Money market	178,802	118,704
Savings	39,626	22,463
Certificates of deposit, under $100,000	169,742	17,250
Certificates of deposit, $100,000 and over	111,653	80,080
Total deposits	770,768	380,614
Borrowings	123,734	55,300
Junior subordinated debentures	27,005	15,464
Accrued interest payable and other liabilities	15,276	5,116
Total liabilities	936,783	456,494
Shareholders equity	128,113	45,069
Total liabilities and shareholders equity	$ 1,064,896	$ 501,563

See accompanying notes.

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FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Condensed consolidated statements of operations

	Three Months Ended March 31, 2007	2006
(in thousands, except per share data)		
Interest and fees on loans	$ 10,158	$ 7,040
Interest on securities	1,693	985
Interest on federal funds sold and interest bearing deposits	446	26
Total interest income	12,297	8,051
Interest on deposits	3,334	1,570
Interest on borrowings	1,458	369
Interest on junior subordinated debentures	359	396
Total interest expense	5,151	2,335
Net interest income	7,146	5,716
Provision for loan losses		32
Net interest income after provision for loan losses	7,146	5,684
Service charges on deposit accounts	367	232
Loan sales and commissions	226	
Trading losses on non-hedge derivatives		(448)
Net settlement on interest rate swap		43
Other income	119	90
Total noninterest income (loss)	712	(83)
Salaries and employee benefits	3,383	2,089
Premises and equipment	628	394
Expense of early termination of debt	1,564	
Integration and conversion expense	3,476	
Other expenses	1,299	1,249
Total noninterest expense	10,350	3,732
Income (loss) before provision for income taxes	(2,492)	1,869
Provision (benefit) for income taxes	(1,397)	813
Net income (loss)	$ (1,095)	$ 1,056
Earnings (loss) per share		
Basic	$ (0.16)	$ 0.19
Diluted	$ (0.15)	$ 0.18

See accompanying notes.

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FIRST CALIFORNIA FINANCIAL GROUP, INC. AND SUBSIDIARIES

Condensed consolidated statements of cash flows

(in thousands)	Three Months Ended March 31, 2007	2006
Net income	(1,095)	$ 1,056
Adjustments to reconcile net income to net cash from operating activities:		
Realized net gains on sale of securities and loans	(226)	(48)
Net amortization of premiums and discounts on securities	(136)	(16)
Net amortization of intangible assets	62	56
Net amortization of premium on loans purchased	15	32
Provision (credit) for loan losses		32
Trading loss on non-hedge derivatives		448
Share-based compensation	83	
Loss on deferred debt issue costs upon redemption	404	
Deferred income taxes		759
Depreciation and amortization	207	116
Net appreciation in cash surrender value of life insurance		
Change in accrued interest receivable and other assets	(3,901)	(473)
Change in accrued interest payable and other liabilities	1,356	187
Net cash (used for) from operating activities	(3,231)	2,149
Net change in federal funds sold		
Proceeds from maturities, calls, and paydowns of securities available-for-sale	6,038	10,114
Proceeds from maturities, calls, and paydowns of securities held-to-maturity	142	169
Proceeds from sales of securities available-for-sale	1,929	
Purchases of securities available-for-sale	(2,643)	(24,513)
Purchases of Federal and other stocks	(600)	(595)
Proceeds from sale of other real estate owned		1,104
Net increase in loans	(15,597)	(14,973)
Net cash & cash equivalents received in acquisition	6,760	
Purchases of premises and equipment	(113)	(132)
Increase in other assets	(32)	
Net cash used for investing activities	(4,116)	(28,826)
Net increase in deposits	(4,645)	16,091
Net increase (decrease) in other borrowings	23,777	(884)
Net increase in securities sold under agreements to repurchase and federal funds purchased	(20)	15,000
Share-based compensation		279
Proceeds from issuance of junior subordinated debentures	16,495	
Redemption of junior subordinated debentures	(15,464)	
Proceeds from exercise of stock options	200	
Net cash from financing activities	20,343	30,486
Change in cash and due from banks	$ 12,995	$ 3,809
Cash and due from banks, beginning of period	13,438	16,192
Cash and due from banks, end of period	$ 26,433	$ 20,001

Supplemental cash flow information:				
Cash paid for interest	$	5,602	$	2,112
Cash paid for income taxes	$	100	$	325
Supplemental disclosure of noncash investing activities				
Issuance of common stock for purchase accounting merger	$	82,982	$	

See accompanying notes to consolidated financial statements.

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NOTE 1 BASIS OF PRESENTATION

Organization and nature of operations First California Financial Group, Inc., or First California or the Company, was incorporated under the laws of the State of Delaware on June 7, 2006. The Company was formed as a wholly-owned subsidiary of National Mercantile Bancorp, a California corporation, or National Mercantile, for the purposes of effecting the merger and capital stock exchange with National Mercantile and acquisition of FCB Bancorp, a California corporation, or FCB.

On June 15, 2006, First California, FCB and National Mercantile entered into an Agreement and Plan of Merger, or the Merger Agreement, providing for the merger of National Mercantile with and into the newly formed holding company, First California, and the conversion of each share of National Mercantile common stock into the right to receive one share of First California common stock and the conversion of each share of FCB common stock into the right to receive 1.7904 shares of First California common stock. In addition, the Merger Agreement provided for the conversion of each share of National Mercantile series B convertible perpetual preferred stock into the right to receive one share of series A convertible perpetual preferred stock, $0.01 par value per share, or First California Preferred Stock, of First California. The merger and acquisition were approved by both National Mercantile and FCB shareholders and regulators.

On March 12, 2007, First California completed the merger and capital stock exchange with National Mercantile and acquisition of FCB pursuant to the Merger Agreement as described above. Concurrently with the merger and acquisition, the number of common shares authorized of First California was increased to 25,000,000 shares and First California authorized the issuance of 2,500,000 shares of preferred stock of which 1,000 shares were designated as series A convertible perpetual preferred stock. In addition, each share of National Mercantile series B convertible perpetual preferred stock was exchanged for one share of series A convertible perpetual preferred stock of First California. As a result of these transactions, First California issued an aggregate of approximately 11.5 million shares of First California Common Stock to former National Mercantile and FCB shareholders and 1,000 shares of First California Preferred Stock to former shareholders of National Mercantile series B convertible preferred stock. First California will pay cash in lieu of fractional shares of First California Common Stock issued in connection with the acquisition of FCB.

Upon completion of the merger of National Mercantile into its wholly-owned subsidiary First California and the acquisition of FCB by First California, the separate corporate existence of National Mercantile and FCB ceased, and First California succeeded, and assumed all the rights and obligations of National Mercantile and FCB. First California assumed all rights and obligations of National Mercantile, whose principal assets were the capital stock of two bank subsidiaries: Mercantile National Bank, or Mercantile, and South Bay Bank, N.A., or South Bay. As a result of the acquisition of FCB, First California acquired all the rights and obligations of FCB, whose principal assets included the capital stock of First California Bank. First California Bank provides a broad range of banking products and services, including credit, cash management and deposit services through eight full service banking offices located in Southern California. As contemplated by the Merger Agreement, First California intends to combine the businesses of the three subsidiary banks under one California state banking charter.

Consolidation The accompanying condensed consolidated financial statements include, in conformity with generally accepted accounting principles, the accounts of the Company, which excludes the accounts of FCB Statutory Trust I and First California Statutory Trust I. Results of operations for the three months ended March 31, 2007 includes operations of FCB from the date of acquisition. All material intercompany transactions have been eliminated.

Basis of presentation The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, all normal recurring adjustments necessary for a fair presentation are reflected in the condensed consolidated financial statements. Operating results for the period ended March 31, 2007 are not necessarily indicative of the results for the full year. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s and National Mercantile s 2006 Annual Report on Form 10-K and Form 10-KSB, respectively.

Management s estimates and assumptions The preparation of the consolidated financial statements, in conformity with generally accepted accounting principles, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheets, and revenues and expenses for the reporting periods. Actual results could differ significantly from those estimates. Significant estimations made by us primarily involve the calculation of the allowance for loan losses, the carrying amount of goodwill and deferred tax assets or liabilities.

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Allowance for loan and lease losses The provisions for credit losses charged to operations reflect management s judgment of the adequacy of the allowance for loan and lease losses and are determined through periodic analysis of the loan portfolio, problem loans and consideration of such other factors as the Company s loan loss experience, trends in problem loans, concentrations of credit risk, and economic conditions (particularly Southern California), as well as the results of the Company s ongoing examination process and its regulatory examinations.

The calculation of the adequacy of the allowance for loan and lease losses is based on a variety of factors, including loan classifications, migration trends and underlying cash flow and collateral values. On a periodic basis, management engages an outside loan review firm to review the Company s loan portfolio, risk grade accuracy and the reasonableness of loan evaluations. Annually, this outside loan review team analyzes the Company s methodology for calculating the allowance for loan and lease losses based on the Company s loss histories and policies. The Company uses a migration analysis as part of its allowance for loan and lease losses evaluation, which is a method by which specific charge-offs are related to the prior life of the same loan compared to the total loan pools in which the loan was graded. This method allows for management to use historical trends that are relative to the Company s portfolio rather than use outside factors that may not take into consideration trends relative to the specific loan portfolio. In addition, this analysis takes into consideration other trends that are qualitative relative to the Company s marketplace, demographic trends, amount and trends in nonperforming assets and concentration factors.

Goodwill and other intangible assets The Company has goodwill, which represents the excess of purchase price over the fair value of net assets acquired primarily as a result of the merger. In accordance with generally accepted accounting principles, goodwill is not amortized and is reviewed for impairment on an annual basis or on an interim basis if an event occurs or circumstances change that would reduce the fair value of a reporting unit below its carrying value. Trade name represents the fair value of the First California Bank name, which is amortized using the straight-line method over a period of ten years. Core deposit intangibles, which represent the intangible value of depositor relationships resulting from deposit liabilities assumed in acquisitions, are amortized using the straight-line method over the projected useful lives of the deposits. Core deposit intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment on goodwill and core deposit intangibles is permanently recognized by writing down the asset to the extent that the carrying value exceeds the estimated fair value.

Income Taxes The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes,* on January 1, 2007. FIN No. 48 prescribes a comprehensive model and provides guidance for accounting and disclosure for uncertainty in tax provisions and for the recognition and measurement related to the accounting for income taxes. FIN No. 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The adoption of FIN 48 did not have a material effect to our financial statements. We have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our accounting policy is to recognize interest and penalties as a component of income tax expense.

Deferred income tax assets and liabilities are determined based on the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. An estimate of probable income tax benefits that will not be realized in future years is required in determining the necessity for a valuation allowance for deferred tax assets. There was no valuation allowance at March 31, 2007 and December 31, 2006.

Common Shares As a result of the merger, the number of common shares outstanding increased to 11.5 million shares at March 31, 2007 from 5.6 million shares outstanding at December 31, 2006.

Recent accounting pronouncements In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 established presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities and to more easily understand the effect of the company s choice to use fair value on its earnings. SFAS No 159 also requires entities to display the fair value of the selected assets and liabilities on the face of the balance sheet. SFAS No. 159 does not eliminate disclosure requirements of other accounting standards, including fair value measurement disclosures in SFAS No. 157. This Statement is effective as of the beginning of

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an entity s first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. Management does not expect the adoption of SFAS No. 159 to have a material impact on the consolidated financial statements.

NOTE 2 MERGER

On March 12, 2007, First California completed the acquisition of 100% of the outstanding common stock of FCB pursuant to the Merger Agreement as described in Note 1 above. FCB was the parent company of First California Bank. At the date of acquisition, First California Bank became a wholly-owned subsidiary of the Company. As provided by the Merger Agreement, approximately 3.278 million shares representing the issued and then outstanding shares of common stock of FCB were exchanged for 5.869 million shares of the Company s common stock at a calculated exchange ratio of 1.7904. Upon completion of the acquisition, the former shareholders of FCB have an approximate 49.9% interest in the Company. The fair value of $14.14 for each of the Company s common shares issued to complete the acquisition of FCB on March 12, 2007 was based on the average of the quoted market price per share of National Mercantile Bancorp s common stock for a period of three days before, the day of and three days after the announcement of the merger on June 15, 2006. In addition, FCB had 160,100 employee stock options outstanding at the acquisition date. On the acquisition date, the Company exchanged the FCB stock options with options to purchase shares of the Company s stock which resulted in the Company granting a total of 286,643 stock options with a weighted average exercise price of $10.33 per share to former FCB employees and executives. The fair value of the stock options of $1.4 million is included in the purchase price.

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Under the purchase method of accounting, the estimated cost of approximately $84.9 million to acquire FCB, including transaction costs, will be allocated to the assets acquired and liabilities assumed based on their respective fair values as of the date of acquisition as summarized below (in thousands, except share and per share amounts):

Purchase Price		
Number of shares of Company stock issued for FCB stock	5,868,586	
Price of the Company s stock on the date of Merger Agreement	$ 14.14	
Total stock consideration		$ 82,982
Fair value of FCB s stock options converted to Company stock options at acquisition date		1,408
Less: Fair value of unvested options related to future service periods		(804)