



**SAEHAN BANCORP AND SUBSIDIARY**

Consolidated Financial Statements

December 31, 2009 and 2008

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
Suite 2000  
355 South Grand Avenue  
Los Angeles, CA 90071-1568

## **Independent Auditors' Report**

The Board of Directors  
Saehan Bancorp:

We have audited the accompanying consolidated statements of financial condition of Saehan Bancorp and subsidiary (the Company) as of December 31, 2009 and 2008 and the related consolidated statements of operations and comprehensive income (loss), changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that the Company plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Saehan Bancorp and subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

April 28, 2010

**SAEHAN BANCORP AND SUBSIDIARY**  
Consolidated Statements of Financial Condition  
December 31, 2009 and 2008

<b>Assets</b>	<b>2009</b>	<b>2008</b>
Cash and due from banks	\$ 15,110,139	16,239,450
Federal funds sold	4,392,000	32,792,000
Cash and cash equivalents	19,502,139	49,031,450
Short-term investment	20,000,000	—
Securities available for sale, at fair value (note 2)	43,862,431	44,399,116
Loans receivable, net of allowance for loan losses: \$42,037,454 in 2009; \$22,157,000 in 2008 (note 4)	529,507,000	709,552,163
Loans held for sale, at the lower of cost or fair value	3,763,545	729,277
Income taxes receivable	9,353,867	3,130,483
Servicing assets	1,230,630	1,548,952
Accrued interest receivable	2,145,255	2,381,589
Deferred income tax assets (note 8)	—	12,939,478
Federal Home Loan Bank stock	5,771,700	5,771,700
Premises and equipment, net (note 5)	4,623,830	6,375,890
Other real estate owned (note 4)	24,930,745	4,415,416
Other assets	3,369,051	2,157,376
Total assets	<u>\$ 668,060,193</u>	<u>842,432,890</u>
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Deposits (note 6):		
Noninterest-bearing demand	\$ 126,484,628	112,387,018
Interest bearing:		
Savings	25,694,535	35,285,675
Money market and super Negotiable Order of Withdrawal (NOW)	63,606,284	100,432,452
Time deposits of \$100,000 or more	275,705,340	278,334,891
Other time deposits	84,688,532	106,185,772
Total deposits	576,179,319	632,625,808
Accrued interest payable	1,908,131	3,143,484
Other borrowed funds (note 7)	60,000,000	121,000,000
Junior subordinated debenture (note 7)	20,619,000	20,619,000
Accounts payable	922,437	129,952
Other liabilities	1,909,333	2,068,479
Total liabilities	<u>661,538,220</u>	<u>779,586,723</u>
Commitments and contingencies (note 11)		
Shareholders' equity (notes 13 and 16):		
Common stock, no par value. Authorized 20,000,000 shares; issued and outstanding 16,032,429 shares at December 31, 2009 and 2008	71,300,915	71,300,915
Additional paid-in capital	2,467,589	2,329,419
Retained deficit	(67,515,805)	(11,086,070)
Accumulated other comprehensive income, net of tax	269,274	301,903
Total shareholders' equity	<u>6,521,973</u>	<u>62,846,167</u>
Total liabilities and shareholders' equity	<u>\$ 668,060,193</u>	<u>842,432,890</u>

See accompanying notes to consolidated financial statements.

**SAEHAN BANCORP AND SUBSIDIARY**

Consolidated Statements of Operations and Comprehensive Income (Loss)

Years ended December 31, 2009 and 2008

	<b>2009</b>	<b>2008</b>
Interest income:		
Interest and fees on loans	\$ 35,332,109	49,825,744
Interest on federal funds sold	73,750	226,250
Interest on securities available for sale and due from banks	1,966,218	1,868,063
Dividend on federal home loan bank stock	—	396,600
Total interest income	37,372,077	52,316,657
Interest expense:		
Interest on deposits (note 6)	17,135,049	20,288,988
Interest on other borrowed funds (note 7)	4,044,538	4,938,345
Total interest expense	21,179,587	25,227,333
Net interest income before provision for loan losses	16,192,490	27,089,324
Provision for loan losses (note 4)	50,815,000	29,786,584
Net interest loss after provision for loan losses	(34,622,510)	(2,697,260)
Noninterest income:		
Service charges on deposits	2,449,360	2,593,517
Gains on sales of loans	359,546	723,103
Letter of credit related fees	585,761	700,582
Loan servicing income	746,311	621,729
Remittance fee income	269,811	254,272
Gain on sale of securities	358,388	—
Gain on sales of premise and equipment	950,062	—
Other income	673,103	903,893
Total noninterest income	6,392,342	5,797,096
Noninterest expenses:		
Salaries and employee benefits (notes 13 and 14)	9,100,365	11,912,587
Occupancy and equipment (notes 5 and 11)	5,073,023	4,974,768
Professional services	2,220,069	1,785,528
Data processing fees	937,086	1,003,546
Directors' compensation	319,765	503,830
Business development expenses	378,380	751,443
Supplies and communication	504,706	659,715
FDIC assessment	2,412,228	824,175
Assessment and administrative expense	704,537	471,889
OREO expenses	1,038,539	357,757
OREO valuation allowances	4,502,484	—
Other operating expenses	1,904,736	1,336,570
Total noninterest expenses	29,095,918	24,581,808
Loss before income tax benefit	(57,326,086)	(21,481,972)
Income tax benefit (note 8)	(896,351)	(8,597,005)
Net loss	(56,429,735)	(12,884,967)
Other comprehensive income (loss):		
Unrealized gain on securities available for sale and interest-only strip	(59,602)	558,469
Income taxes on other comprehensive income	26,973	(211,140)
Other comprehensive income, net of tax	(32,629)	347,329
Total comprehensive loss	\$ (56,462,364)	(12,537,638)
Losses per share (note 9):		
Basic	\$ (3.52)	(1.04)
Diluted	(3.52)	(1.04)
Weighted average shares outstanding:		
Basic	\$ 16,032,429	12,401,413
Diluted	16,035,433	12,401,413

See accompanying notes to consolidated financial statements.

**SAEHAN BANCORP AND SUBSIDIARY**  
Consolidated Statements of Changes in Shareholders' Equity  
Years ended December 31, 2009 and 2008

	<u>Shares outstanding</u>	<u>Common stock</u>	<u>Additional paid-in capital</u>	<u>Retained deficit</u>	<u>Accumulated other comprehensive income</u>	<u>Total shareholders' equity</u>
Balance at December 31, 2007	11,160,737	\$ 52,262,108	1,933,257	7,022,245	(45,426)	61,172,184
8% stock dividend	892,717	5,222,394	—	(5,222,394)	—	—
Cash paid for fractional shares	—	—	—	(954)	—	(954)
Issuance of common stocks	3,978,975	13,816,413	—	—	—	13,816,413
Share-based compensation cost	—	—	396,162	—	—	396,162
Comprehensive loss:						
Net loss	—	—	—	(12,884,967)	—	(12,884,967)
Change in unrealized gain on securities available for sale, net of tax	—	—	—	—	335,574	335,574
Change in unrealized gain on interest-only strip, net of tax	—	—	—	—	11,755	11,755
Total comprehensive loss						<u>(12,537,638)</u>
Balance at December 31, 2008	16,032,429	71,300,915	2,329,419	(11,086,070)	301,903	62,846,167
Share-based compensation cost	—	—	138,170	—	—	138,170
Comprehensive loss:						
Net loss	—	—	—	(56,429,735)	—	(56,429,735)
Change in unrealized loss on securities available for sale, net of tax	—	—	—	—	(39,138)	(39,138)
Change in unrealized gain on interest-only strip, net of tax	—	—	—	—	6,509	6,509
Total comprehensive loss						<u>(56,462,364)</u>
Balance at December 31, 2009	<u>16,032,429</u>	<u>\$ 71,300,915</u>	<u>2,467,589</u>	<u>(67,515,805)</u>	<u>269,274</u>	<u>6,521,973</u>

See accompanying notes to consolidated financial statements.

**SAEHAN BANCORP AND SUBSIDIARY**

Consolidated Statements of Cash Flows

Years ended December 31, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss	\$ (56,429,735)	(12,884,967)
Adjustments to reconcile net loss to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	1,863,785	1,871,279
Amortization of discount/premium on securities available for sale, net	1,009,442	26,518
Share-based compensation expense	138,170	396,162
Provision for loan losses	50,815,000	29,786,584
Federal Home Loan Bank stock dividends	—	(396,600)
Gain on sales of securities available for sale	(358,388)	—
Other-than-temporary impairment loss on securities	—	356,500
Loss (gain) on disposition of premise and equipment	(950,062)	182,876
Gain on sales of loans	(359,546)	(723,103)
Loss (gain) on sales of other real estate owned	130,529	(260,184)
Provision for valuation allowance on other real estate owned	4,502,484	—
Origination from sales of loans held for sale	(8,663,357)	(22,604,095)
Proceeds from sales of loans held for sale	5,988,635	23,358,995
Decrease in accrued interest receivable	236,334	892,197
Increase in income taxes receivable	(6,223,384)	(3,130,483)
Decrease (increase) in deferred tax assets	12,977,264	(8,934,816)
Decrease in servicing asset	318,322	175,544
Decrease in other assets	(1,211,675)	(3,778,794)
Increase in accrued interest payable	(1,235,353)	(317,053)
Decrease (increase) in other liabilities	633,339	(528,138)
Net cash and cash equivalents provided by operating activities	<u>3,181,804</u>	<u>3,488,422</u>
Cash flows from investing activities:		
Net increase (decrease) in loans receivable	101,539,857	(52,546,992)
Proceeds from sale of OREO	2,541,965	—
Purchases of securities available for sale	(59,706,332)	(6,987,813)
Proceeds from sale, matured, or called securities available for sale	59,521,547	15,457,272
Short-term investment	(20,000,000)	—
Proceeds from Sale of Federal Home Loan Bank stock	—	1,831,400
Net payments for premise and equipment	838,337	(1,359,300)
Net cash and cash equivalents provided by (used in) investing activities	<u>84,735,374</u>	<u>(43,605,433)</u>
Cash flows from financing activities:		
Net decrease in deposits	(56,446,489)	(5,923,015)
Proceeds from repayment of other borrowed funds	(61,000,000)	24,500,000
Proceeds from issuance of common stock	—	13,816,413
Stock dividend paid in cash for fractional shares	—	(954)
Net cash and cash equivalents provided by (used in) financing activities	<u>(117,446,489)</u>	<u>32,392,444</u>
Net decrease in cash and cash equivalents	(29,529,311)	(7,724,567)
Cash and cash equivalents, beginning of year	49,031,450	56,756,017
Cash and cash equivalents, end of year	\$ <u>19,502,139</u>	<u>49,031,450</u>
Supplemental disclosures of cash flow information:		
Cash paid during the years for:		
Interest	\$ 22,414,940	24,910,281
Income taxes	—	2,390,051
Noncash financing activities:		
Transfer of retained earnings to common stock for stock dividend	—	5,222,394
Transfer of loans to other real estate owned	\$ 20,515,329	4,415,416
Loan provided in the sale of other real estate owned	200,000	—

See accompanying notes to consolidated financial statements.

## SAEHAN BANCORP AND SUBSIDIARY

### Notes to Consolidated Financial Statements

December 31, 2009 and 2008

#### (1) Summary of Significant Accounting Policies

The accompanying consolidated financial statements include the accounts of Saehan Bancorp (Bancorp) and its wholly owned subsidiary, Saehan Bank (Bank). The Bank's primary operations are related to traditional banking activities, including acceptance of deposits and lending of loans. The Bank's primary deposit products are demand and time deposits, and its primary lending products are commercial business loans. The Bank maintains 10 branch offices in the Greater Los Angeles area and three loan production offices in other areas. The Bank's principal client base comprises small to mid-size businesses, entrepreneurs, professionals, and individuals. The Bank offers a broad range of lending, deposit, international banking, and other products and services.

##### (a) *Principles of Consolidation and Basis of Presentation*

The consolidated financial statements include the accounts of the Bancorp and the Bank (collectively, the Company). All material intercompany transactions and balances have been eliminated in the consolidation. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP) and to prevailing practices within the banking industry.

The Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC or Codification) became effective on July 1, 2009. At that date, the ASC became FASB's officially recognized source of authoritative GAAP applicable to all public and nonpublic nongovernmental entities, superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force, and related literature. All other accounting literature is considered nonauthoritative. The switch to the ASC affects the way companies refer to GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section, and Paragraph structure.

##### (b) *Use of Estimates*

The preparation of these consolidated financial statements 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 consolidated financial statements and the reported amounts of revenues and expenses during the reported periods. Circumstances and events that differ significantly from those underlying the estimates and assumptions could cause actual financial results to differ from the estimates. The material estimates included in the consolidated financial statements relate to the allowance for loan losses, other-than-temporary impairment (OTTI) analysis on investments, fair value disclosures, and income taxes.

##### (c) *Cash and Cash Equivalents*

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash in process of collection, due from banks, and federal funds sold. Generally, federal funds are purchased and sold for an one-day period. The Company is required to maintain minimum reserve balances with the Federal Reserve Bank under the Federal Reserve Act. The reserve requirement balance was zero at December 31, 2009 and approximately \$3.3 million at December 31, 2008.

## SAEHAN BANCORP AND SUBSIDIARY

### Notes to Consolidated Financial Statements

December 31, 2009 and 2008

#### (d) *Securities Available for Sale*

Investment securities are classified into one of three categories and accounted for as follows:

- Securities that the Company has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and reported at amortized cost, adjusted for amortization of premiums and accretion of discounts.
- Securities that are bought and held principally for the purpose of selling in the near future are classified as “trading securities” and reported at fair value. Unrealized gains and losses are recognized in earnings.
- Securities not classified as held-to-maturity or trading securities are classified as “available-for-sale” and reported at fair value. Unrealized gains and losses are reported, net of taxes, as a separate component of accumulated other comprehensive income in shareholders’ equity.

Accreted discounts and amortized premiums on investment securities are included in interest income, and unrealized and realized gains or losses related to holding or selling securities are calculated using the specific-identification method.

FASB ASC Topic 320, *Investments – Debt and Equity Securities*, requires an entity to assess whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. If either of these conditions is met, an entity must recognize an OTTI. If an entity does not intend to sell the debt security and will not be required to sell the debt security, the entity must consider whether it will recover the amortized cost basis of the security. If the present value of expected cash flows is less than the amortized cost basis of the security, OTTI shall have considered to have occurred. OTTI is then separated into the amount of the total impairment related to credit losses and the amount of the total impairment related to all other factors. An entity determines the impairment related to credit losses by comparing the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. OTTI related to the credit loss is then recognized in earnings. OTTI related to all other factors is recognized in other comprehensive income. OTTI not related to the credit loss for a held-to-maturity security should be recognized separately in a new category of other comprehensive income and amortized over the remaining life of the debt security as an increase in the carrying value of the security only when the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its remaining amortized cost basis. The entity expects to recover the amortized cost basis of its debt securities, and has no intent to sell and will not be required to sell available-for-sale securities that decline below their cost before their anticipated recovery. At December 31, 2009, there was no OTTI related to credit losses to be recognized in earnings.

There were no trading or held-to-maturity investment securities at December 31, 2009 and 2008.

#### (e) *Loans Receivable*

Loans receivable are reported at the principal amount outstanding, net of deferred loan fees and unearned income. Interest revenue on loans is generally accrued based on the principal amount

## SAEHAN BANCORP AND SUBSIDIARY

### Notes to Consolidated Financial Statements

December 31, 2009 and 2008

outstanding. Interest income is not recognized on loans if collection of the interest is deemed to be unlikely. Loan origination fees are deferred and amortized over the terms of the related loans as adjustments to the loans' yields.

Loans are placed on nonaccrual when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent interest payments are received. The loan is generally returned to accrual status when the borrower has brought the past-due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled. A nonaccrual loan may also be returned to accrual status if all principal and interest contractually due are reasonably assured of repayment within a reasonable period and there has been a sustained period of payment performance, generally six months.

(f) ***Allowance for Loan Losses***

Loan losses are charged, and recoveries are credited, to the allowance for loan losses account. Additions to the allowance for loan losses account are charged to the provision for the credit losses. Charge-offs to the allowance for loan losses are made when specific assets are considered uncollectible or are transferred to real estate acquired in settlement of loans and the fair value of the property is less than the loan's recorded investment. Recoveries are credited to the allowance for loan losses.

The total allowance for loan losses consists of two components: specific allowances and general allowances. To determine the adequacy of the allowance in each of these two components, two primary methodologies are employed: the individual loan review analysis methodology and the classification migration methodology. These methodologies support the basis for determining allocations between the various loan categories and the overall adequacy of the allowance to provide for probable losses inherent in the loan portfolio. These methodologies are further supported by additional analysis of relevant factors such as the historical losses in the portfolio, and environmental factors that include trends in delinquency and nonaccrual, and other significant factors, such as the national and local economy, the volume and composition of the portfolio, strength of management and loan staff, underwriting standards, and the concentration of credit.

The Company's management allocates a specific allowance for impaired credits, in accordance with FASB ASC Subtopic 310-10, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Allowance for impaired loans are generally determined based on collateral value less selling costs or the present value of estimated cash flows, depending on type of underlying collateral. For nonimpaired credits, a general allowance is established for those loans internally classified and risk graded based on historical losses in the specific loan portfolio and a reserve based on environmental factors determined for that loan group. The level of the general allowance is established to provide coverage for management's estimate of the credit risk in the loan portfolio by various loan segments not covered by the specific allowance.

Although management uses available information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values, and future cash flows on

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### Notes to Consolidated Financial Statements

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impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term.

**(g) Other Real Estate Owned**

Assets acquired through loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

**(h) Loans Held-for-Sale and Servicing Asset**

Loans designated as held-for-sale in the secondary market are carried at the lower of cost or market value in the individual asset basis. Loan fees and costs are deferred and recognized as a component of gain or loss on sale of loans when the loans are sold. Net unrealized losses are recognized through a valuation allowance established by charges to operations.

Certain Small Business Administration (SBA) loans that may be sold prior to maturity are designated as held-for-sale at origination and are recorded at the lower of cost or market, determined on an aggregate basis. A valuation allowance is established if the market value of such loans is lower than their cost, and operations are charged or credited for valuation adjustments. A portion of the gain on sale of SBA loans is recognized as other noninterest income at the time of the sale. The remaining portion of the gain, presented as unearned income in note 3, is deferred and amortized over the remaining life of the loans as an adjustment to yield.

Upon sale of such loans, the Bank receives a fee for servicing the loans. The servicing asset is recorded based on the present value of the contractually specified servicing fee, net of servicing cost, over the estimated life of the loan, using a discount rate of 1% above the main note rate, with an average discount rate of 7.40%, and an average constant prepayment rate of 17.75% in 2008. During 2009, the discount rate was 1.0% above the main note rate, with an average discount rate of 5.78% and an average constant prepayment rate of 14.58%. The servicing asset is amortized in proportion to and over the period of estimated servicing income. The Bank has capitalized \$129,283 and \$409,080 and of servicing assets and amortized \$447,605 and \$584,624 during the years ended December 31, 2009 and 2008, respectively. Management periodically evaluates the servicing assets for impairment. Impairment, if it occurs, is recognized in a valuation allowance in the period of impairment. No impairment existed at December 31, 2009 and 2008.

An interest-only strip is recorded based on the present value of the excess of future interest income, over the contractually specified servicing fee, calculated using the same assumptions as noted above. Interest-only strip receivables are accounted for at fair value, with unrealized gains or losses recorded as an adjustment in accumulated other comprehensive income in shareholders' equity.

**(i) Premises and Equipment**

Premises and equipment are stated at cost, less accumulated depreciation, computed on a straight-line basis over the estimated useful lives of the assets. Equipment is depreciated over three to ten years, and leasehold improvements are amortized over the lesser of the terms of the respective leases or the estimated useful lives. Repairs and maintenance are charged to operating expenses as incurred. Costs of improvements are added to the applicable property accounts.

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**(j) Junior Subordinated Debentures**

The Company has established a statutory business trust (the Trust) that is a wholly owned subsidiary of Saehan Bancorp. The Trust issued variable rate capital security representing undivided preferred beneficial interests in the assets of the Trust. Saehan Bancorp is the owner of all the beneficial interests represented by the common securities of the Trust.

FASB ASC 810, *Consolidation of Variable Interest Entities (Revised December 2003)* – an *Interpretation of ARB No. 51*, requires that variable interest entities be consolidated by a company if that company is subject to a majority of expected loss from the variable interest entity’s activities or is entitled to receive a majority of the entity’s expected residual returns or both. The Trust is not consolidated and junior subordinated debt represents liabilities of the Bancorp to the Trust.

**(k) Income Taxes**

Income taxes are provided for the tax effects of the transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between financial and income tax reporting of the allowance for loan losses and accumulated depreciation. The deferred income tax assets and liabilities represent the future tax return consequences of those differences, which will be either taxable or deductible when the assets and liabilities are recovered or settled.

**(l) Federal Home Loan Bank Stock**

As a member of the Federal Home Loan Bank (FHLB) System, the Bank’s required investment in FHLB stock carried at cost amounted to \$5,771,700 at December 31, 2009 and 2008. A new capital plan of the FHLB was approved by the Federal Housing Finance Board and was implemented on April 1, 2004. Each member is required to own a minimum stock amount required equal to the greater of 1% of membership asset value or 4.7% of FHLB advances.

**(m) Stock Based Compensation**

The Company adopted FASB ASC 718, *Compensation-Stock Compensation*, on January 1, 2006 using the “modified prospective” method. Under this method, awards that are granted, modified, or settled after December 31, 2005 are measured and accounted for in accordance with FASB ASC 718. Also under this method, expense is recognized for services attributed to the current period for unvested awards that were granted prior to January 1, 2006, based upon the fair value determined at the grant date under FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Prior to the adoption of FASB ASC 718, the Company accounted for stock compensation under the intrinsic value method permitted by Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, the Company previously recognized no compensation cost for employee stock options that were granted with an exercise price equal to the market value of the underlying common stock on the date of grant.

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FASB ASC 718 requires that cash flows resulting from the realization of excess tax benefits recognized on awards that were fully vested at the time of adoption of FASB ASC 718 be classified as a financing cash inflow and an operating cash outflow on the consolidated statements of cash flows. Before the adoption of FASB ASC 718, the Company presented all tax benefits realized from the exercise of stock options as an operating cash inflow.

In addition, FASB ASC 718 requires that any unearned compensation related to awards granted prior to the adoption of FASB ASC 718 be eliminated against the appropriate equity accounts. As a result, the presentation of stockholders' equity was revised to reflect the transfer of the balance previously reported in unearned compensation to additional paid-in capital.

**(n) Earnings per Share**

Basic earnings per share (EPS) is computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of securities that could share in the earnings.

**(o) Reclassification**

Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the current financial statement presentation.

**(p) Segment Reporting**

Through its ten-branch network, the Company provides a broad range of financial services to individuals and companies located primarily in southern California. These services include demand, time and savings deposits, loans and international banking, and other services. While the Company's chief decision makers monitor the revenue streams of the Company's various products and services, operations are managed and financial performance is evaluated on a companywide basis. Accordingly, the Company considers all of its operations are aggregated in one reportable operating segment.

**(q) Recent Accounting Pronouncements**

FASB ASC 105, *Generally Accepted Accounting Principles* – The FASB ASC is the exclusive authoritative reference for nongovernmental U.S. GAAP for use in financial statements issued for interim and annual periods ending after September 15, 2009, except for Securities and Exchange Commission (SEC) rules and interpretive releases, which are also authoritative GAAP for SEC registrants. The contents of the Codification will carry the same level of authority, eliminating the four-level GAAP hierarchy previously set forth. The FASB ASC supersedes all existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the FASB ASC is nonauthoritative. FASB ASC 105 did not have a material effect on the Company's financial condition or results of operations.

FASB ASC 855, *Subsequent Events* – FASB ASC 855 addresses accounting and disclosure requirements related to subsequent events. FASB ASC 855 requires management to evaluate subsequent events through the date the financial statements are either issued or available to be issued, depending on the company's expectation of whether it will widely distribute its financial

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statements to its shareholders and other financial statement users. Companies are required to disclose the date through which subsequent events have been evaluated. FASB ASC 855 is effective for interim or annual financial periods ending after June 15, 2009 and should be applied prospectively. The adoption of FASB ASC 855 did not have a material effect on the Company's financial condition or results of operations.

FASB Accounting Standards Updates (ASU) 2010-06, *Fair Value Measurements and Disclosures* (Topic 820) – ASU 2010-06 adds new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation, entities will be required to provide fair value measurement disclosures for each class of assets and liabilities, and about inputs and valuation techniques used to measure fair value. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010. Adoption of ASU 2010-06 is not expected to have a significant impact on the Company's consolidated financial statements.

FASB ASU 2009-16, *Accounting for Transfers of Financial Assets* – ASU 2009-16 removes the concept of a qualifying special-purpose entity (QSPE) from ASC Topic 860, *Transfers and Servicing*, and the exception from applying ASC Subtopic 810-10, *Consolidation to QSPEs*, thereby requiring transferors of financial assets to evaluate whether to consolidate transferees that previously were considered QSPEs. Transferor-imposed constraints on transferees whose sole purpose is to engage in securitization or asset-backed financing activities are evaluated in the same manner under the provisions of the ASU as transferor-imposed constraints on QSPEs were evaluated under the provisions of Topic 860 prior to the effective date of the ASU when determining whether a transfer of financial assets qualifies for sale accounting. The ASU also clarifies the Topic 860 sale-accounting criteria pertaining to legal isolation and effective control and creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale. The ASU is effective for periods beginning after December 15, 2009, and may not be early adopted. The Company expects that the adoption of ASU 2009-16 will not have a material impact on its consolidated financial statements.

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**(2) Securities Available for Sale**

The following is a summary of securities available for sale at December 31, 2009 and 2008:

	<u>Amortized cost</u>	<u>Gross unrealized gain</u>	<u>Gross unrealized loss</u>	<u>Estimated fair value</u>
2009:				
U.S. government-sponsored agency securities	\$ 29,393,224	128,866	—	29,522,090
Mortgage-backed securities (1)	14,039,405	334,158	47,822	14,325,741
FNMA preferred stock	3,500	11,100	—	14,600
Total	<u>\$ 43,436,129</u>	<u>474,124</u>	<u>47,822</u>	<u>43,862,431</u>
2008:				
U.S. government-sponsored agency securities	\$ 15,975,319	342,426	—	16,317,745
Mortgage-backed securities	16,022,510	208,045	76,096	16,154,459
Municipal bonds	11,901,069	67,252	46,609	11,921,712
FNMA preferred stock	3,500	1,700	—	5,200
Total	<u>\$ 43,902,398</u>	<u>619,423</u>	<u>122,705</u>	<u>44,399,116</u>

(1) Collateralized by residential mortgages and guaranteed by U.S. government sponsored entities.

The Company has sold all municipal securities and a gain of \$358,388 was realized in 2009. Additionally, accrued interest and dividends receivable on investment securities totaled \$295,036 and \$330,597 at December 31, 2009 and 2008, respectively.

Gross unrealized losses on investment securities and the fair value of the related investment securities, aggregated by the investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of December 31, 2009 and 2008:

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>
2009:						
U.S. government-sponsored agency securities	\$ —	—	—	—	—	—
Mortgage-backed securities	47,822	3,046,938	—	—	47,822	3,046,938
FNMA preferred stock	—	—	—	—	—	—
Total	<u>\$ 47,822</u>	<u>3,046,938</u>	<u>—</u>	<u>—</u>	<u>47,822</u>	<u>3,046,938</u>

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	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>
2008:						
U.S. government-sponsored agency securities	\$ —	—	—	—	—	—
Municipal bonds	46,609	4,233,488	—	—	46,609	4,233,488
Mortgage-backed securities	76,096	6,477,373	—	—	76,096	6,477,373
FNMA preferred stock	—	—	—	—	—	—
Total	\$ 122,705	10,710,861	—	—	122,705	10,710,861

All individual securities that have been in a continuous unrealized loss position for less than 12 months at December 31, 2009 had investment grade ratings upon purchase. The issuers of these securities have not, to the Company's knowledge, established any cause for default on these securities, and the various rating agencies have reaffirmed these securities' long-term investment grade status at December 31, 2009. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated. FASB ASC 320 requires an entity to assess whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell the investments before the recovery of its amortized cost bases. Therefore, in management's opinion, all securities that have been in a continuous unrealized loss position for less than 12 months or longer as of December 31, 2009 and 2008 are not other-than-temporarily impaired, and therefore, no impairment charges as of December 31, 2009 and 2008 are warranted on these securities.

In September 2008, the Federal Housing Finance Agency placed Fannie Mae under receivership and suspended indefinitely the payment of future dividends on their issues of preferred stock. In light of these developments, the Company recognized in 2008, an OTTI loss of \$356,500 related to a credit loss on its agency preferred stocks to write down the value of these securities to their respective market values as of December 31, 2008. As of December 31, 2009, the Company held Fannie Mae preferred stock with carrying value of \$14,600.

The amortized cost and estimated fair value of securities available for sale at December 31, 2009, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Amortized cost</u>	<u>Estimated fair value</u>
Due within one year	\$ 32,531,878	32,696,748
Due after one year through five years	1,833,809	1,877,338
Due after five years through ten years	1,443,096	1,507,268
Due after ten years	7,623,846	7,766,477
FNMA preferred stock	3,500	14,600
Total	\$ 43,436,129	43,862,431

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Realized gains and losses on sales of investment securities, proceeds from sales of investment securities, and the tax expense on sales of investment securities were as follows for the periods indicated:

	Year ended December 31	
	2009	2008
Gross realized gains on sale of investment securities	\$ 361,306	—
Gross realized losses on sales of investment securities	(2,918)	—
Net realized gains on sales of investment securities	\$ 358,388	—
Proceeds from sales of investment securities	\$ 30,748,209	—
Tax expense on sale of investment securities	—	—

Securities with amortized cost of approximately \$1,000,000 and \$9,997,000 at December 31, 2009 and 2008, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

### (3) Fair Value Measurements

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It also 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.

FASB ASC 825, *Financial Instruments*, provides additional guidance for estimating fair value in accordance with FASB ASC 820 when the volume and level of activity for the asset or liability have significantly decreased. It also includes guidance on identifying circumstances that indicate a transaction is not orderly. FASB ASC 825 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. FASB ASC 825 also requires additional disclosures relating to fair value measurement inputs and valuation techniques, as well as providing disclosures for all debt and equity investment securities by major security types rather than by major security categories that should be based on the nature and risks of the security during both interim and annual periods. FASB ASC is effective for interim and annual reporting periods ending after June 15, 2009 and does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, FASB ASC 825 requires comparative disclosures only for periods ending after initial adoption.

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FASB ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a three-level fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value are defined as follows:

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

The Company used the following methods and assumptions in estimating our fair value disclosure for financial instruments:

*Securities Available for Sale* – The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, as well as other U.S. government agency debentures that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include mortgage-backed securities and municipal bonds. The Company does not have any Level 3 investment securities.

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

*Impaired Loans* – The Company does not record loans at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to collateral-dependent impaired loans are recorded based on either the current appraised value of the collateral, a Level 2 measurement, or management's judgment and estimation of value reported on old appraisals, which are then adjusted based on recent market trends, a Level 3 measurement.

*Other Real Estate Owned* – Real estate acquired in the settlement of loans is initially recorded at fair value, less estimated costs to sell. The Company records other real estate owned at fair value on a nonrecurring basis. However, from time to time, nonrecurring fair value adjustments to other real estate owned are recorded based on the current appraised value of the property, a Level 2 measurement, or management's judgment and estimation based on the reported appraisal value, a Level 3 measurement.

*Servicing Assets and Servicing Liabilities* – The fair values of servicing assets and servicing liabilities are based on a valuation model that calculates the present value of estimated net future cash flows related to

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contractually specify servicing fees. The valuation model incorporates assumptions that market participants would use in estimating future cash flows. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness. Fair value measurements of servicing assets and servicing liabilities use significant unobservable inputs. As such, The Company classifies them as Level 3.

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

As of December 31, 2009, assets and liabilities measured at fair value on a recurring basis are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Balance as of</u>
	<u>Quoted prices</u>			<u>December 31,</u>
	<u>in active</u>			<u>2009</u>
	<u>markets for</u>	<u>Significant</u>	<u>Significant</u>	
	<u>identical</u>	<u>observable</u>	<u>unobservable</u>	
	<u>assets</u>	<u>inputs</u>	<u>inputs</u>	
Assets:				
Securities available for sale:				
U. S. government agency securities	\$ 29,522,090	—	—	29,522,090
Mortgage-backed securities	—	14,325,741	—	14,325,741
FNMA preferred stock	14,600	—	—	14,600
Total securities available for sale	<u>\$ 29,536,690</u>	<u>14,325,741</u>	<u>—</u>	<u>43,862,431</u>
Servicing assets	\$ —	—	1,230,630	1,230,630
Liabilities:				
Servicing liabilities	\$ —	—	82,843	82,843

The table below presents a reconciliation and income statement classification of gains and losses for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2009:

	<u>Fair value measurements using significant unobservable inputs (Level 3)</u>					
	<u>Beginning</u>		<u>Realized and</u>	<u>Realized and</u>		<u>Ending</u>
	<u>balance as of</u>	<u>Purchases,</u>	<u>unrealized</u>	<u>unrealized</u>	<u>Transfers</u>	<u>balance as of</u>
	<u>January 1,</u>	<u>issuances and</u>	<u>losses</u>	<u>gains in other</u>	<u>in and/or out</u>	<u>December 31,</u>
	<u>2009</u>	<u>settlements</u>	<u>in earnings</u>	<u>comprehensive</u>	<u>of Level 3</u>	<u>2009</u>
Assets:						
Servicing assets	\$ 1,548,952	129,283	(447,605)	—	—	1,230,630
Liabilities:						
Servicing liabilities	\$ 88,291	—	(5,448)	—	—	82,843

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***Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis***

As of December 31, 2009, assets and liabilities measured at fair value on a nonrecurring basis are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
	<u>Quoted prices in active markets for identical assets</u>	<u>Significant observable inputs with no active market with identical characteristics</u>	<u>Significant unobservable inputs</u>	<u>Balance as of December 31, 2009</u>
Assets:				
Loans held for sale	\$ —	3,763,545	—	3,763,545
Impaired loans	—	68,706,504	14,296,481	83,002,985
Other real estate owned	—	21,915,365	3,015,380	24,930,745

***Assets and Liabilities Not Measured at Fair Value on a Recurring or Nonrecurring Basis***

FASB ASC 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring basis or nonrecurring basis are discussed above.

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The Company estimates fair value amounts of financial instruments using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop estimates of fair value amounts. Accordingly, the estimates presented herein do not necessarily indicate the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimates of fair value amounts.

	<b>December 31, 2009</b>		<b>December 31, 2008</b>	
	<b>Carrying amount</b>	<b>Estimated fair value</b>	<b>Carrying amount</b>	<b>Estimated fair value</b>
<b>Assets:</b>				
Cash and cash equivalents	\$ 19,502,139	19,502,139	49,031,450	49,031,450
Short-term investments	20,000,000	20,000,000	—	—
Securities available for sale	43,862,431	43,862,431	44,399,116	44,399,116
Loans receivable, net of allowance for loan losses	529,507,000	507,717,968	708,822,886	704,151,635
Loans held for sale	3,763,545	3,763,545	729,277	729,277
Accrued interest receivable	2,145,255	2,145,255	2,381,589	2,381,589
Federal Home Loan Bank stock	5,771,700	5,771,700	5,771,700	5,771,700
<b>Liabilities:</b>				
Deposits	\$ 576,179,319	575,260,373	632,625,808	632,686,222
Other borrowed funds	60,000,000	62,786,020	121,000,000	124,045,095
Junior subordinated debentures	20,619,000	20,619,000	20,619,000	20,619,000
Accrued interest payable	1,908,131	1,908,131	3,143,484	3,143,484

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

**(a) Cash and Cash Equivalents**

The carrying amounts approximate fair values due to the short-term nature of these instruments.

**(b) Short-Term investment**

The carrying amounts approximate fair values due to the short-term nature of these instruments.

**(c) Securities Available for Sale**

The fair value of securities equals quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

**(d) Loans Receivable, Net of Allowance for Loan Losses**

For variable rate loans that reprice frequently with no significant change in credit risk, carrying amounts approximate fair values. Fair values of other loans (for example, fixed rate real estate and rental property mortgage loans, and commercial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of

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similar credit quality. The estimated fair values of loans include judgments regarding future expected loss and risk characteristics. The estimated fair value is net of allowance for loan losses.

**(e) *Accrued Interest Receivable***

The carrying amounts of accrued interest receivable approximate fair values due to its short-term nature.

**(f) *Federal Home Loan Bank Stock***

The carrying amounts approximate fair value as the stock may be resold to the issuer at carrying value.

**(g) *Deposits***

The fair values of demand deposits such as interest-bearing checking accounts, savings accounts, super NOW accounts, and money market demand accounts are, by definition, equal to the amounts payable on demand at the reporting date (that is, their carrying amounts). The fair values of certificates of deposit are estimated using a discounted cash flow analysis that applies interest rates currently being offered to certificates with similar remaining maturity.

**(h) *Other Borrowed Funds and Junior Subordinated Debentures***

Discount cash flows have been used to value FHLB advances and for variable rate of junior subordinated debentures that resets quarterly, the carrying amount approximates fair values.

**(i) *Accrued Interest Payable***

The carrying amounts of accrued interest payable approximate its fair value due to its short-term nature.

**(j) *Commitment to Extend Credit and Standby Letter of Credit***

The fair value of loan commitments and standby letters of credit is estimated using the fees currently charged to enter into similar agreements. The estimated fair values of these are excluded from the above table because it is not material.

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**(4) Loans Receivable and Allowance for Loan Losses**

The following is a summary of loans by major categories at December 31, 2009 and 2008:

	<b>2009</b>	<b>2008</b>
Real estate loans	\$ 400,465,739	465,258,785
Construction loans	15,649,921	33,585,655
Commercial loans	143,364,550	210,917,605
Consumer loans	13,730,837	24,155,527
Total	573,211,047	733,917,572
Less:		
Deferred loan fees and unearned income	(1,666,593)	(2,208,409)
Allowance for loan losses	(42,037,454)	(22,157,000)
Net loans	\$ 529,507,000	709,552,163

As of December 31, 2009 and 2008, the Company serviced loans sold to unaffiliated parties in the amount of approximately \$115,366,000 and \$130,024,000, respectively.

An analysis of the activity in the allowance for loan losses and reserve for off-balance credit losses for the years ended December 31, 2009 and 2008 is as follows:

	<b>2009</b>		<b>2008</b>	
	<b>Allowance for loan losses</b>	<b>Allowance for off-balance sheet items</b>	<b>Allowance for loan losses</b>	<b>Allowance for off-balance sheet items</b>
Balance, beginning of year	\$ 22,157,000	472,340	8,248,568	317,000
Provision charged to operating expenses	50,815,000	976,084	29,786,584	155,340
Loan recoveries	1,798,003	—	386,152	—
Loans charged off	(32,732,549)	—	(16,264,304)	—
Balance, end of year	\$ 42,037,454	1,448,424	22,157,000	472,340

The reserve for off-balance credit losses, recorded in other liabilities, is primarily related to undisbursed funds on line of credit.

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The following is a summary of impaired loans at December 31, 2009 and 2008:

	<u>Balance</u>	<u>Allowance</u>
At December 31, 2009:		
With no allocated allowance:		
Without charge-off	\$ 22,570,864	—
With charge-off	8,919,348	—
With allocated allowance:		
Without charge-off	37,491,516	12,841,515
With charge-off	<u>14,021,257</u>	<u>2,922,245</u>
Total	\$ <u>83,002,985</u>	<u>15,763,760</u>
At December 31, 2008:		
With no allocated allowance:		
Without charge-off	\$ 34,196,434	—
With charge-off	8,587,912	—
With allocated allowance:		
Without charge-off	26,096,089	8,777,344
With charge-off	<u>5,429,699</u>	<u>693,419</u>
Total	\$ <u>74,310,134</u>	<u>9,470,763</u>

At December 31, 2009 and 2008, the average balance of impaired loans was \$92,577,129 and \$78,475,897, respectively. Interest income of \$4,012,062 and \$2,184,948 was recognized on impaired loans during the years ended December 31, 2009 and 2008, respectively. Loans on which the accrual of interest has been discontinued amounted to \$52,536,822 and \$42,012,121 at December 31, 2009 and 2008, respectively. If interest on these loans had been accrued, interest income would have increased by approximately \$1,851,378 in 2009 and \$1,154,862 in 2008. The following table provides information of the Company's nonaccrual loans as of December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Real estate loans	\$ 49,192,725	39,486,523
Commercial and industrial loans	3,306,789	2,363,877
Consumer loans	<u>37,308</u>	<u>161,721</u>
Total nonaccrual loans	\$ <u>52,536,822</u>	<u>42,012,121</u>

The Company is not committed to lend additional funds to debtors whose loans are considered to be impaired. Additionally, there were no loans past due 90 days or more still accruing at December 31, 2009 and 2008.

**(a) Other Real Estate Owned (OREO)**

As of December 31, 2009, there were 13 OREO properties with a combined net carrying value of \$24,930,745. During the year ended December 31, 2009, eight OREO properties, with a carrying value of \$2,672,494, were sold, and a loss of \$130,529 was realized. During the year ended

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December 31, 2008, an OREO property, with a carrying value of \$1,042,152, was sold, and a gain of \$260,184 was realized.

**(b) Troubled Debt Restructuring**

A troubled debt restructuring (TDR) is a formal modification of the terms of a loan when the lender, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, or extension of the maturity date. Although these loan modifications are considered under FASB ASC 310-40, *Troubled Debt Restructurings by Creditors*, the loans have, pursuant to the Company's policy, performed under the restructured terms and have demonstrated sustained performance under the modified terms for six months before being returned to accrual status. The sustained performance considered by management pursuant to its policy includes the periods prior to the modification if the prior performance met or exceeded the modified terms. This would include cash paid by the borrower prior to the restructure to set up interest reserves. TDR loans totaled \$56,222,092 and \$24,314,980 at December 31, 2009 and 2008, respectively, and the related allowances were \$10,104,791 and \$2,016,444, respectively.

As of December 31, 2009, there were no commitments to lend additional funds to those borrowers whose loans have been restructured, were considered impaired, or were on nonaccrual status.

**(5) Premises and Equipment**

Premises and equipment at December 31, 2009 and 2008 consisted of the following:

	<b>2009</b>	<b>2008</b>
Land	\$ —	336,116
Leasehold improvements	6,063,491	6,026,845
Equipment, furniture, and fixtures	4,703,677	4,658,727
Computer software	1,044,082	1,029,355
Total	11,811,250	12,051,043
Less accumulated depreciation	(7,187,420)	(5,675,152)
Premise and equipment, net	\$ 4,623,830	6,375,891

Total depreciation and amortization included in occupancy and equipment expenses was \$1,863,785 and \$1,871,279 for the years ended December 31, 2009 and 2008, respectively.

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**(6) Deposits**

The scheduled maturities of time deposits were as follows at December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Three months or less	\$ 81,320,920	139,748,069
Over three months to twelve months	88,740,892	244,542,335
Over twelve months	<u>190,332,060</u>	<u>230,259</u>
Total	<u>\$ 360,393,872</u>	<u>384,520,663</u>

A summary of interest expense related to deposits and other borrowings is as follows for the years ended December 31, 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Super Negotiable Order of Withdrawal (NOW)	\$ 7,109	21,381
Money market funds and savings	2,984,395	4,649,012
Time deposits:		
\$100,000 or more	10,103,787	10,374,499
Other time deposits	4,039,758	5,244,096
Other	<u>4,044,538</u>	<u>4,938,345</u>
Total	<u>\$ 21,179,587</u>	<u>25,227,333</u>

Accrued interest payable on deposits totaled \$1,329,339 and \$2,918,479 at December 31, 2009 and 2008, respectively.

The Company is currently restricted from accepting brokered deposits as a funding source. As of December 31, 2009 and 2008, brokered deposits were \$190,209,000 and \$110,000,000, respectively. The interest for the years ended December 31, 2009 and 2008 was 3.05% and 4.27%, respectively.

**(7) Other Borrowed Funds and Junior Subordinated Debentures**

The Company has a line of credit with the FHLB with total outstanding amount of \$60,000,000 and maturities of two years or less at December 31, 2009. The interest rates range from 4.92% to 5.29%.

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FHLB advances represent collateralized obligations with the FHLB. The following is a summary of contractual maturities pertaining to FHLB advances:

	2009		2008	
	Amount	Weighted average interest rate	Amount	Weighted average interest rate
Year of maturity:				
2009	\$ —	—%	\$ 61,000,000	1.26%
2010	35,000,000	5.06	35,000,000	5.06
2011	20,000,000	5.11	20,000,000	5.11
2012	5,000,000	5.09	5,000,000	5.09
	\$ 60,000,000	5.08%	\$ 121,000,000	3.15%

The Company has pledged loans receivable with carrying values of \$217.9 million as collateral with the FHLB for this borrowing facility. The total borrowing capacity available from the collateral that has been pledged is \$98.7 million, of which \$36.3 million remained available as of December 31, 2009.

For the years ended December 31, 2009 and 2008, interest expense on FHLB advances totaled \$4.0 million and \$3.9 million, respectively, and the weighted average interest rates were 5.08% and 3.15%, respectively.

***Junior Subordinated Debentures***

In March 2007, the Company issued a junior subordinated note bearing interest at the three-month London InterBank Offered Rate (LIBOR) plus 1.62% totaling \$20,619,000. The note has a floating rate, which resets quarterly. Under the terms and transactions, the note will mature in March 2037 and is redeemable, in whole or in part, without penalty, at the option of the Bancorp after June 30, 2012.

In November 2008, the Bancorp committed to the Federal Reserve Bank of San Francisco (the FRB) that no interest payments on the junior subordinated debentures would be made without the prior written consent of the FRB. In addition, the limitations imposed by the FRB prohibited the Bank from providing a dividend to the Bancorp without the prior written consent of the FRB. Therefore, in order to preserve its capital position, Bancorp's board of directors has elected to defer quarterly interest payments on its outstanding junior subordinated debentures until further notice, beginning with the interest payment that was due on June 30, 2009. No dividend was declared during 2009 and 2008. See note 15, *Regulatory Matters*, for further discussion.

For the years ended December 31, 2009 and 2008, interest expense on the junior subordinated debentures totaled \$510,022 and \$1,037,108, respectively, and weighted average interest rates were 2.51% and 5.01%, respectively. Accrued interest payable of \$357,362 is included to the interest expense on junior subordinated debentures as of December 31, 2009.

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**(8) Income Taxes**

The provisions for income taxes for the years ended December 31, 2009 and 2008 are summarized as follows:

	<u>2009</u>	<u>2008</u>
Current income tax expense (benefit):		
Federal	\$ (13,780,048)	203,535
State	(82,754)	377,114
Total	<u>(13,862,802)</u>	<u>580,649</u>
Deferred income tax expense (benefit):		
Federal	9,437,313	(6,547,999)
State	3,529,138	(2,629,655)
Total	<u>12,966,451</u>	<u>(9,177,654)</u>
Income tax benefit	\$ <u>(896,351)</u>	<u>(8,597,005)</u>

As of December 31, 2009, the Company recorded a valuation allowance of \$26.2 million on the deferred tax assets, after considering all available evidence related to the amount of the deferred tax asset that is more likely than not to be realized. The change in the valuation allowance is netted and recorded in the provision for income taxes.

	<u>2009</u>	<u>2008</u>
Allowance for loan losses	\$ 18,212,624	9,323,968
Accumulated depreciation	778,447	347,404
Share-based compensation expense	350,249	201,687
Net operating loss	12,487,880	5,958,258
Other	3,053,314	736,829
Total deferred income tax assets	<u>34,882,514</u>	<u>16,568,146</u>
Unrealized gain on available-for-sale securities	(184,167)	(211,140)
Mark-to-market accounting for loans receivables		
net of allowance for loan losses	(8,486,277)	(2,153,992)
State taxes	(14,052)	(1,213,687)
Total deferred income tax liabilities	<u>(8,684,496)</u>	<u>(3,578,819)</u>
Valuation allowance	<u>(26,198,018)</u>	<u>(49,849)</u>
Net deferred income tax assets	\$ <u>—</u>	<u>12,939,478</u>

In accessing the realization of deferred income tax assets, management considers whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during

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the periods in which those temporary differences become deductible. Based upon factors such as the scheduled reversal of temporary differences and projected future taxable income, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

The principal reasons for the difference in the effective tax rate and the federal statutory rate are as follows:

	<u>2009</u>	<u>2008</u>
Federal income tax at statutory tax rate	34%	34%
Net state income tax	(4)	7
Valuation allowance	(29)	—
Others	—	(1)
	<u>1%</u>	<u>40%</u>

Income tax receivables were \$9,353,867 and \$3,130,483 at December 31, 2009 and 2008, respectively.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, included in FASB ASC 740, *Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attributes of income tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain tax position taken or expected to be taken on an income tax return must be recognized in the financial statements at the largest amount that is more likely than not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized in the financial statements unless it is more likely than not of being sustained. The Company adopted the provisions of FIN 48 on January 1, 2009, and there was no material effect on the consolidated financial statements as of the date of the adoption. Because of the implementation, there was no cumulative effect related to adopting FIN 48.

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**(9) Earnings Per Share**

The following is a reconciliation of the numerators and denominators of the basic and diluted per share computations at December 31, 2009 and 2008:

	<u>Income (loss)</u> <u>(numerator)</u>	<u>Weighted</u> <u>shares</u> <u>(denominator)</u>	<u>Per share</u> <u>amount</u>
2009:			
Basic EPS – income available to common shareholders	\$ (56,429,735)	16,032,429	\$ (3.52)
Effect of dilutive securities:			
Stock options assumed exercised	<u>—</u>	<u>3,004</u>	<u>—</u>
Diluted EPS – income available to common shareholders	\$ <u><u>(56,429,735)</u></u>	\$ <u><u>16,035,433</u></u>	\$ <u><u>(3.52)</u></u>
2008:			
Basic EPS – income available to common shareholders	\$ (12,884,966)	12,401,413	\$ (1.04)
Effect of dilutive securities:			
Stock options assumed exercised	<u>—</u>	<u>—</u>	<u>—</u>
Diluted EPS – income available to common shareholders	\$ <u><u>(12,884,966)</u></u>	\$ <u><u>12,401,413</u></u>	\$ <u><u>(1.04)</u></u>

**(10) Related-Party Transactions**

As part of its normal banking activities, the Company has extended credit to its directors and officers. All such extensions of credits are on terms similar to transactions with nonaffiliated parties and involve only normal credit risks.

The following summarizes the activities during 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	\$ 6,633,676	4,507,444
New loans originated	—	2,172,346
Principal repayments	<u>(6,539,802)</u>	<u>(46,114)</u>
Balance at end of year	\$ <u><u>93,874</u></u>	\$ <u><u>6,633,676</u></u>

The principal repayment of \$6,539,802 includes the balance belonged to a director who resigned from the board in 2009.

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#### (11) Commitments and Contingencies

The consolidated financial statements do not reflect various other commitments and contingent liabilities, such as commitments to extend credit and letters of credit, which arise in the normal course of business. The Company leases its premises from unaffiliated parties under noncancelable operating leases. Future noncancelable minimum rental commitments under the operating leases approximated the following amounts:

	<u>Amount</u>
Year ending December 31:	
2010	\$ 2,446,011
2011	2,334,330
2012	1,430,169
2013	1,300,721
2014	1,236,139
Thereafter	<u>1,131,904</u>
Total	<u>\$ 9,879,274</u>

The total rental expense recorded under such leases for 2009 and 2008 amounted to approximately \$2,714,000 and \$2,645,000, respectively.

#### *Litigation*

In the normal course of business, the Company is involved in various legal claims. Management has reviewed all legal claims against the Company with outside legal counsel and has taken into consideration the views of such counsel as to the outcome of the claims. In management's opinion, the final disposition of all such claims will not have a material adverse effect on the Company's financial position or results of operations.

#### (12) Off-Balance-Sheet Credit Risk

In the normal course of meeting the financing needs of our customers, the Company is a party to financial instruments with off-balance-sheet credit risk. These financial instruments include commitments to extend credit, which are legally binding loan commitments with set expiration dates. They are intended to be disbursed, subject to certain conditions, upon request of the borrower. The Company evaluates the creditworthiness of each customer. The Company requires collateral or other security to support off-balance-sheet financial instruments with credit risk. However, when the commitment is funded, the Company receives collateral to the extent deemed necessary. The amount of collateral obtained, if deemed necessary by the Company upon the extension of credit, is based upon management's evaluation.

Collateral held varies, but may include accounts receivable, inventory, personal property, equipment, and income-producing commercial or residential properties. At December 31, 2009 and 2008, the Company had loan commitments granted and undisbursed of \$38,796,431 and \$65,505,423, commitments under outstanding commercial letters of credit of \$5,153,277 and \$3,516,159, standby letters of credit and guarantees of \$3,287,604 and \$13,793,459, respectively. Management does not anticipate any material losses as a result of these transactions.

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**(13) Employee Share-Based Compensation**

The Company has three stock option plans, under which options to purchase shares of the Company's common stock may be granted to key employees and directors as of December 31, 2009. There are the 1998 Stock Option Plan (1998 Plan), the 2004 Stock Option Plan (2004 Plan), and the 2006 Stock Option Plan (2006 Plan).

**(a) 1998 Plan**

Under the 1998 Plan, the total numbers of option shares that can be granted are 2,589,902 shares, and the options shall not be less than the fair value of the Company's stock on the effective date of grant. Options will vest over three to five years. No option may be granted with a term of more than 10 years. There were no options granted under the 1998 Plan in 2009 and 2008.

The following is a summary of the 1998 Plan transactions for the years ended December 31, 2009 and 2008:

	2009		2008	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Options outstanding – beginning of year	31,748	\$ 3.83	31,748	\$ 3.83
Options exercised	—		—	
Options forfeited	—		—	
Options outstanding – end of year	31,748	3.83	31,748	3.83
Options exercisable – end of year	31,748	3.83	31,748	3.83

For the years ended December 31, 2009 and 2008, no compensation expense for the 1998 Plan was recognized in the consolidated statements of operations.

As of December 31, 2009 and 2008, stock options outstanding under the 1998 Plan were as follows:

	Options outstanding				Options exercisable			
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2009:								
\$3.75 through \$4.00	31,748	\$ —	3.83	0.65	31,748	\$ —	3.83	0.65

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	Options outstanding				Options exercisable			
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2008:								
\$3.75 through \$4.00	31,748	\$ —	3.83	1.65	31,748	\$ —	3.83	1.65

**(b) 2004 Plan**

Under the 2004 Plan, the total numbers of option shares that can be granted are 1,349,188 shares, and the options shall not be less than the fair value of the Company's stock on the effective date of grant. Options will vest over three to five years. No option may be granted with a term of more than 10 years.

There was no share of options granted under the 2004 Plan for the years ended December 31, 2009 and 2008.

The following information under the 2004 Plan is presented for the years ended December 31, 2009 and 2008:

	Year ended December 31	
	2009	2008
Grant date fair value of options granted	\$ —	—
Fair value of options vested	84,346	191,268
Total intrinsic value of options exercised	—	—
Cash received from options exercised	—	—
Actual tax benefit realized from tax deductions on options exercised	—	—

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The following is a summary of the stock option activity during 2009 and 2008 under the 2004 Plan:

	2009		2008	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Options outstanding – beginning of year	610,925	\$ 10.95	709,051	\$ 10.73
Options granted	—		—	
Options exercised	—		—	
Options forfeited	<u>(287,357)</u>	12.61	<u>(98,126)</u>	9.38
Options outstanding – end of year	<u>323,568</u>	9.48	<u>610,925</u>	10.95
Options exercisable – end of year	317,728	9.46	550,962	10.53

For the years ended December 31, 2009 and 2008, compensation expense of \$17,141 and \$131,585, respectively, for the 2004 Plan was recognized in the consolidated statements of operations.

As of December 31, 2009 and 2008, stock options outstanding under the 2004 Plan were as follows:

	Options outstanding				Options exercisable			
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2009:								
\$9.00 through \$9.49	294,366	\$ —	9.38	4.95	294,366	\$ —	9.38	4.95
\$9.50 through \$10.49	11,681	—	10.49	1.68	9,345	—	10.49	1.68
\$10.50 through \$10.99	17,521	—	10.55	1.84	14,017	—	10.55	1.84
	<u>323,568</u>	\$ —	9.48	4.66	<u>317,728</u>	\$ —	9.46	4.71

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	Options outstanding				Options exercisable			
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2008:								
\$9.00 through \$9.49	441,549	\$ —	9.38	5.95	441,549	\$ —	9.38	5.95
\$9.50 through \$10.49	35,043	—	10.42	2.80	21,025	—	10.42	2.80
\$10.50 through \$10.99	17,521	—	10.55	2.84	10,513	—	10.55	2.84
\$17.00 through \$17.99	116,812	—	17.12	7.09	77,875	—	17.12	7.09
	<u>610,925</u>	<u>\$ —</u>	<u>10.95</u>	<u>5.90</u>	<u>550,962</u>	<u>\$ —</u>	<u>10.53</u>	<u>5.93</u>

**(c) 2006 Plan**

Under the 2006 Plan, the total numbers of option shares that can be granted are 584,064 shares, and the options shall not be less than the fair value of the Company's stock on the effective date of grant. Options will vest over three to five years. No option may be granted with a term of more than 10 years.

In March 2008, the board of directors approved the acceleration of the vesting schedule of employees who modified their options in December 2007 to match the last vesting date of original vesting schedule. The remaining unrecognized compensation expense is accelerated in accordance with the new vesting schedule.

For the years ended December 31, 2009 and 2008, the estimated weighted average fair value per share of options granted under the 2006 Plan was as follows:

	Year ended December 31	
	2009	2008
Estimated weighted average fair value per share of options granted	\$ 0.78	0.94

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The estimated weighted average fair value per share of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	<b>Year ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Weighted average assumptions:		
Expected volatility	37.51%	26.26%
Expected term	5.27 years	5.30 years
Risk-free interest rate	1.77%	2.45%
Expected forfeiture rate	6.72%	5.69%

Expected volatility is determined based on the historical weekly volatility of stock price of California Community Banks, which are listed on the National Stock Market with total assets up to \$2 billion, over a period equal to expected term of the options granted. The expected term of the options represents the period of time that options granted are expected to be outstanding based primarily on the historical exercise behavior associated with previous option grants. The risk-free interest rate is based on the U.S. Treasury yield curve at the time of grant for a period equal to the expected term of the options granted.

The following information under the 2006 Plan is presented for the years ended December 31, 2009 and 2008:

	<b>Year ended December 31</b>	
	<b>2009</b>	<b>2008</b>
Grant date fair value of options granted	\$ 16,372	103,685
Fair value of options vested	182,751	164,115
Total intrinsic value of options exercised	—	—
Cash received from options exercised	—	—
Actual tax benefit realized from tax deductions on options exercised	—	—

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The following is a summary of the stock option activity during 2009 and 2008 under the 2006 Plan:

	2009		2008	
	Number of shares	Weighted average exercise price per share	Number of shares	Weighted average exercise price per share
Options outstanding – beginning of year	292,927	\$ 7.63	287,837	\$ 9.78
Options granted	21,000	2.15	111,997	4.43
Options exercised	—	—	—	—
Options forfeited	(79,710)	8.30	(106,908)	10.06
Options outstanding – end of year	<u>234,217</u>	6.92	<u>292,927</u>	7.63
Options exercisable – end of year	75,251	7.93	53,022	9.68

For the years ended December 31, 2009 and 2008, compensation expense of \$121,029 and \$264,577 for the 2006 Plan was recognized in the consolidated statements of operations.

As of December 31, 2009 and 2008, stock options outstanding under the 2006 Plan were as follows:

	Options outstanding				Options exercisable			
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2009:								
\$3.00 through \$3.99	36,000	\$ —	2.50	4.97	3,000	\$ —	3.00	4.82
\$4.00 through \$6.99	97,000	—	4.65	7.48	28,733	—	4.45	7.88
\$7.00 through \$9.99	25,272	—	7.87	3.95	12,470	—	7.87	3.95
\$10.00 through \$10.99	39,312	—	10.26	3.41	15,723	—	10.26	3.41
\$11.00 through \$13.00	36,633	—	12.99	3.29	15,325	—	13.09	3.27
	<u>234,217</u>	<u>\$ —</u>	<u>6.92</u>	<u>5.37</u>	<u>75,251</u>	<u>\$ —</u>	<u>7.93</u>	<u>5.23</u>

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	Options outstanding			Options exercisable				
	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life	Number of shares	Intrinsic value	Average exercise price per share	Weighted average remaining contractual life
2008:								
\$3.00 through \$3.99	15,000	\$ —	3.00	5.82	—	\$ —	—	—
\$4.00 through \$6.99	194,519	—	6.28	7.86	31,367	—	7.99	7.10
\$10.00 through \$10.99	40,435	—	10.26	4.29	8,984	—	10.26	4.27
\$11.00 through \$11.99	10,800	—	11.11	4.47	2,160	—	11.11	4.47
\$13.00 through \$13.99	27,136	—	13.63	3.57	9,164	—	13.75	2.13
\$15.00 through \$15.99	3,369	—	15.14	3.70	1,347	—	15.14	3.70
	<u>291,259</u>	<u>\$ —</u>	<u>7.63</u>	<u>6.68</u>	<u>53,022</u>	<u>\$ —</u>	<u>9.68</u>	<u>5.57</u>

**(14) Employee Benefit Plans**

The Company has a 401(k) plan for the benefit of its employees. The Company stopped to match 100% of the employees' contribution up to 5% of each participant's annual compensation as of July 1, 2009. Contributions to the 401(k) plan for the years ended December 31, 2009 and 2008 were approximately \$120,400 and \$342,800, respectively.

**(15) Regulatory Matters**

**(a) Regulatory Order**

The Bancorp and the Bank are subject to extensive federal and state supervision and regulation by certain regulatory agencies. In connection with such supervision and their recent examinations, the regulatory agencies will require that certain deficiencies in the Company's policies, procedures, or activities be corrected in the future. If such matters are not corrected in the future or significant progress is not made on such matters, then the Bancorp and/or the Bank may face additional regulatory action that may have an impact on the operations of the Bancorp and the Bank.

On December 7, 2009, the members of the Board of the Bank entered into a consent order (the Order) with the Federal Deposit Insurance Corporation (the FDIC) to address certain issues raised in the Bank's most recent regulatory examination by the Department of Financial Institutions (DFI) and FDIC on June 30, 2009. Certain of the issues to be addressed by management under the terms of the consent order relate to the following, among others: (i) retain management acceptable to the DFI and the FDIC; (ii) notify the DFI and the FDIC prior to adding any individual as a senior executive officer of the Bank or a director; (iii) maintain a minimum Tier 1 leverage capital ratio of not less than 8.0%, within 60 days from the effective date of the Order; (iv) maintain a minimum Tier 1 leverage capital ratio of not less than 10.0%, within 90 days from the effective date of the Order; (v) develop and adopt a plan to meet and maintain the capital requirement of the Order, within 30 days from the effective date of the Order; (vi) maintain the level of capital in addition to a fully funded allowance for loan and lease losses during the life of the Order; and (vii) provide periodic progress reports to the DFI and the FDIC detailing the form and manner of any actions to secure compliance with the consent order.

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On January 21, 2010, the Bancorp, the holding company for the Bank, entered into a written agreement (the Agreement) with the Federal Reserve Bank of San Francisco (the FRB). The Agreement is designed to enhance the Company's ability to act as a source of strength to the Bank. The Agreement authorizes the Company's board of directors to fully utilize its resources to comply with the terms of the Consent Order issued to the Bank by its federal regulators. Pursuant to the Agreement, the Company agreed to seek the prior written approval of the FRB before undertaking any of the following activities: a) declaring or paying any dividends; b) directly or indirectly taking dividends or any other form of payment representing a reduction in capital from the Bank; c) making any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities; d) directly or indirectly, incurring, increasing, or guaranteeing any debt; and e) directly or indirectly purchasing or redeeming any shares of its stock. The Company has no plans to undertake any of these activities due to its plan to preserve capital and to inject additional capital into the Company. Within 30 days of the Agreement, the Company shall submit to the FRB a written plan designed to maintain sufficient capital at the Company on a consolidated basis and at the Bank as a separate stand-alone entity. The Agreement does not contain specific target capital ratios to be obtained or specific timelines, but requires that the plan address the Company's current and future capital requirements, the Bank's current and future capital requirements, the adequacy of the Bank's capital, taking into account its risk profile, and the source and timing of additional funds to satisfy the Company's and the Bank's future capital requirements. In addition, within 60 days of the Agreement, the Company shall submit to the FRB a written statement of the Company's planned sources and uses of cash for debt service, operating expenses, and other purposes for 2010 and subsequent years. The Company also agreed to comply with certain notice provisions set forth in the Federal Deposit Insurance Act (the FDIA) and Board of Governors Regulations in appointing any new director or senior executive officer, or changing the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position. The Company will also be required to comply with certain restrictions on indemnification and severance payments pursuant to the FDIA and FDIC regulations. The Company will provide quarterly written progress reports to the FRB. The provisions of the Agreement remain effective and enforceable until stayed, modified, terminated, or suspended by the FRB.

On January 28, 2010, the Bank entered into a Memorandum of Understanding (Memorandum) with the FDIC to address certain issues in the Compliance Report of Examination. Certain of the issues to be addressed within 60 days from the effective date of the Memorandum by management under the terms of the Memorandum relate to the following, among others: 1) increase board of directors' oversight of the Bank's compliance function and monitor and ensure compliance with the Memorandum; 2) the compliance officer be provided with adequate time and sufficient resources to effectively perform all assigned duties as compliance and Community Reinvestment Act (CRA) officer; 3) the board of directors shall approve and implement all applicable consumer policies and procedures; 4) the board of directors will oversee the implementation of procedures to enhance internal monitoring to ensure compliance with all applicable consumer lending and deposit regulations; 5) establish and reevaluate an ongoing training program for all bank personnel; 6) strengthen the compliance audit function to ensure the audit scope adequately addresses the ongoing compliance needs and risk profile of the Bank; 7) the board of directors shall ensure the correction of all violations of Part 339 of the Rules and Regulations; 8) the board of directors will

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ensure the correction of all violations listed in the Compliance Report; and 9) within 30 days after the end of each quarter, the board of directors shall furnish written progress reports to the FDIC.

The board of directors and management are committed to addressing and resolving issues raised in the Order on a timely basis. Since the Bank entered into the Order, actions have been already been undertaken to resolve or make progress on the issues raised by the Order. For further disclosure on the maintenance of Tier 1 leverage capital ratio, see *Note 16 — Subsequent Events*.

To comply with the provisions of the Agreement and the Order, additional actions taken by the board of directors and management include the following:

- The audit department retains an outside loan reviewer to conduct an independent credit review on loans with an outstanding balance in excess of \$750,000 on a semi-annual basis.
- The board of directors monitors the progress toward full compliance with all the provisions of the Agreement and the Order on a monthly basis
- Loan policies and procedures continue to be enhanced to keep current with the rapidly changing credit and economic environment.
- Monthly internal watch loan reports that list criticized and classified loans are prepared by management and are provided to the board of directors. The Chief Credit Officer also reviews the delinquent loans report weekly.
- Allowance for loan loss is reviewed by the board of directors on a quarterly basis.
- The credit department increased the level of management loan review and loan monitoring.

If the Bank is not able to complete a substantial portion of the Order or Agreement, its regulatory capital ratios may be materially and adversely affected and its ability to withstand continued adverse economic conditions could be threatened. Any material failure to comply with the provisions could result in further enforcement actions by certain regulatory agencies or placing the Bank into conservatorship or receivership.

#### **(b) Regulatory Capital**

The Bancorp and the Bank are required to maintain a certain minimum level of regulatory capital as defined by the banking regulators. 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 Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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

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(as defined). As of December 31, 2009, the Bancorp and the Bank are significantly under capital adequacy requirements to which they are subject.

Notwithstanding the above regulatory remark, the Bancorp and Bank's actual capital amounts and ratios are as follows at December 31, 2009 and 2008:

	Actual		For capital adequacy purpose		To be well capitalized under prompt corrective action provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
2009:						
Total capital (to risk-weighted assets):						
Bancorp	\$ 16,674	2.8%	\$ 48,407	8.0%	\$ —	N/A
Bank	34,284	5.7	48,406	8.0	60,507	10.0
Tier I capital (to risk-weighted assets):						
Bancorp	8,337	1.4	24,203	4.0	—	N/A
Bank	26,272	4.3	24,203	4.0	36,304	6.0
Tier I capital (to average assets):						
Bancorp	8,337	1.1	30,415	4.0	—	N/A
Bank	26,272	3.5	30,375	4.0	37,969	5.0
(Dollars in thousands)						
2008:						
Total capital (to risk-weighted assets):						
Bancorp	\$ 92,524	11.8%	\$ 62,856	8.0%	\$ —	N/A
Bank	89,777	11.4	62,841	8.0	78,552	10.0
Tier I capital (to risk-weighted assets):						
Bancorp	82,545	10.5	31,428	4.0	—	N/A
Bank	79,800	10.2	31,421	4.0	47,131	6.0
Tier I capital (to average assets):						
Bancorp	82,545	9.9	33,440	4.0	—	N/A
Bank	79,800	9.6	33,412	4.0	41,765	5.0

### (16) Subsequent Events

Management has evaluated subsequent events through April 28, 2010, the date of issuance of the financial data included herein. There have been no subsequent events that occurred during such period that would require disclosure in the consolidated financial statements or would be required to be recognized in the consolidated financial statements as of December 31, 2009, except as disclosed below.

The Bank received agreement from the California DFI and the FDIC not to take any extreme action against the Bank with respect to compliance with certain capital ratio requirements. Under the terms of the

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Consent Order with the DFI and FDIC, which became effective as of December 7, 2009, the Bank was required to attain a Tier 1 capital leverage ratio of 8% by February 5, 2010 and 10% by March 8, 2010. As of February 5, 2010, the DFI and FDIC agreed to not to take any extreme action against the Bank until after March 8, 2010 while maintaining the requirement that the Bank attain a Tier 1 capital leverage ratio of 10% by such date.

The Company consummated a privately negotiated \$60.6 million common stock sale transaction to accredited investors on March 9, 2010. Subsequent to the receipt of the proceeds from the transaction, the Company was notified by the DFI and the FDIC to extend the compliance due date from March 8, 2010 to March 11, 2010. On March 9, 2010, the Company contributed \$55.0 million out of total proceeds from the transaction as new capital into the Bank. As of March 9, 2010, the Bank attained a Tier 1 capital leverage ratio of 11.3%, which was in excess of 10% as required under the Consent Order dated December 7, 2009 with the FDIC and the DFI.

#### (17) Condensed Financial Statements of Parent Company

The following presents the unconsolidated condensed financial statements of the parent company, Bancorp, as of December 31, 2009 and 2008:

	<b>2009</b>	<b>2008</b>
Statements of financial condition:		
Assets:		
Cash and cash equivalents	\$ 332,076	2,572,794
Investment in Saehan Bank	26,541,709	80,101,148
Investment in trust preferred securities	619,000	619,000
Deferred income tax asset	—	186,326
Other assets	10,000	—
Total assets	\$ 27,502,785	83,479,268
Liabilities and shareholders' equity:		
Junior subordinated debenture	\$ 20,619,000	20,619,000
Other liabilities	361,812	14,100
Shareholders' equity	6,521,973	62,846,168
Total liabilities and shareholders' equity	\$ 27,502,785	83,479,268
Statements of operations:		
Other operating expense	\$ (1,013,364)	(1,821,614)
Equity in net loss of Saehan Bank	(56,312,721)	(11,354,262)
Income tax benefit	896,351	290,909
Net loss	\$ (56,429,734)	(12,884,967)

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	<u>2009</u>	<u>2008</u>
Statements of cash flows:		
Cash flows from operating activities:		
Net loss	\$ (56,429,734)	(12,884,967)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Equity in net loss of Saehan Bank	56,312,721	11,354,262
Share-based compensation expense	138,170	396,162
Decrease (increase) in deferred tax asset	(599,587)	192,946
Decrease (increase) in other assets	(10,000)	345,427
Increase (decrease) in other liabilities	347,712	(16,011)
Net cash and cash equivalents used in operating activities	<u>(240,718)</u>	<u>(612,181)</u>
Cash flows from investing activity:		
Payments for investments in subsidiary	<u>(2,000,000)</u>	<u>(13,000,000)</u>
Net cash and cash equivalents used in investing activity	<u>(2,000,000)</u>	<u>(13,000,000)</u>
Cash flows from financing activities:		
Common stock issued through private placement	—	13,816,413
Stock dividend paid-in cash for fractional shares	—	(954)
Net cash and cash equivalents provided by financing activities	<u>—</u>	<u>13,815,459</u>
Net increase (decrease) in cash and cash equivalents	(2,240,718)	203,278
Cash and cash equivalents, beginning of year	<u>2,572,794</u>	<u>2,369,516</u>
Cash and cash equivalents, end of year	\$ <u><u>332,076</u></u>	<u><u>2,572,794</u></u>