



SAEHAN BANCORP AND SUBSIDIARY

Consolidated Financial Statements

December 31, 2006 and 2005

(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 as of December 31, 2006 and 2005, and the related consolidated statements of income and comprehensive income, 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 we plan and perform the audit to obtain reasonable assurance about whether the consolidated 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, 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, 2006 and 2005, 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 5, 2007

SAEHAN BANCORP AND SUBSIDIARY
Consolidated Statements of Financial Condition
December 31, 2006 and 2005

| Assets | 2006 | 2005 |
|---|-----------------------|--------------------|
| Cash and due from banks | \$ 18,704,562 | 15,892,086 |
| Federal funds sold | 11,785,000 | 7,045,000 |
| Cash and cash equivalents | 30,489,562 | 22,937,086 |
| Securities available for sale, at fair value (note 2) | 56,064,533 | 55,473,634 |
| Loans receivable, net of allowance for loan losses: \$5,477,827 in 2006; \$4,687,276 in 2005 (note 3) | 523,341,146 | 421,180,408 |
| Loans held for sale, at the lower of cost or fair value | 1,070,916 | — |
| Customers' liabilities on acceptance | 117,858 | 517,640 |
| Servicing assets | 1,288,117 | 1,219,353 |
| Accrued interest receivable | 2,863,278 | 2,267,702 |
| Deferred income tax assets (note 7) | 3,164,993 | 2,523,709 |
| Federal Home Loan Bank stock | 2,558,700 | 2,640,200 |
| Premises and equipment, net (note 4) | 6,152,983 | 3,449,869 |
| Other assets | 690,724 | 825,346 |
| Total assets | <u>\$ 627,802,810</u> | <u>513,034,947</u> |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Deposits (note 5): | | |
| Noninterest-bearing demand | \$ 120,964,320 | 107,110,755 |
| Interest bearing: | | |
| Savings | 20,116,386 | 21,940,849 |
| Money market and super Negotiable Order of Withdrawal (NOW) | 106,877,653 | 84,752,798 |
| Time deposits of \$100,000 or more | 189,881,374 | 179,311,205 |
| Other time deposits | 82,711,846 | 27,224,416 |
| Total deposits | 520,551,579 | 420,340,023 |
| Accrued interest payable | 3,918,807 | 1,816,558 |
| Federal funds purchased | — | 5,000,000 |
| Other borrowed funds (note 6) | 47,000,000 | 37,000,000 |
| Other liabilities | 3,531,722 | 3,773,033 |
| Acceptance outstanding | 117,858 | 517,640 |
| Total liabilities | <u>575,119,966</u> | <u>468,447,254</u> |
| Commitments and contingencies (note 10) | | |
| Shareholders' equity (notes 12 and 15): | | |
| Common stock, no par value. Authorized 20,000,000 shares; issued and outstanding 10,663,052 and 10,000,662 shares at December 31, 2006 and 2005, respectively | 46,583,162 | 39,259,554 |
| Additional paid-in capital | 1,110,524 | 16,331 |
| Retained earnings | 5,558,550 | 5,994,656 |
| Accumulated other comprehensive loss | (569,392) | (682,848) |
| Total shareholders' equity | <u>52,682,844</u> | <u>44,587,693</u> |
| Total liabilities and shareholders' equity | <u>\$ 627,802,810</u> | <u>513,034,947</u> |

See accompanying notes to consolidated financial statements.

SAEHAN BANCORP AND SUBSIDIARY

Consolidated Statements of Income and Comprehensive Income

Years ended December 31, 2006 and 2005

| | 2006 | 2005 |
|---|---------------|------------|
| Interest income: | | |
| Interest and fees on loans | \$ 39,683,046 | 27,919,663 |
| Interest on federal funds sold | 878,233 | 148,297 |
| Interest on securities available for sale and due from banks | 2,607,049 | 2,110,998 |
| Total interest income | 43,168,328 | 30,178,958 |
| Interest expense: | | |
| Interest on deposits (note 5) | 16,316,699 | 7,432,516 |
| Interest on other borrowed funds (note 5) | 1,414,258 | 1,336,713 |
| Total interest expense | 17,730,957 | 8,769,229 |
| Net interest income before provision for credit losses | 25,437,371 | 21,409,729 |
| Provision for credit losses (note 3) | 1,563,000 | 1,471,800 |
| Net interest income after provision for credit losses | 23,874,371 | 19,937,929 |
| Noninterest income: | | |
| Service charges on deposits | 2,187,513 | 3,076,180 |
| Gains on sales of loans | 2,451,116 | 2,021,323 |
| Letter of credit related fees | 795,140 | 943,522 |
| Loan servicing income | 865,305 | 803,759 |
| Remittance fee income | 200,998 | 199,977 |
| Other income | 407,226 | 278,505 |
| Total noninterest income | 6,907,298 | 7,323,266 |
| Noninterest expenses: | | |
| Salaries and employee benefits (notes 12 and 13) | 12,368,296 | 8,779,815 |
| Occupancy and equipment (notes 4 and 10) | 2,907,124 | 2,323,187 |
| Professional services | 1,482,335 | 1,058,765 |
| Data processing fees | 778,118 | 658,170 |
| Directors' compensation | 520,840 | 487,763 |
| Business development expenses | 1,146,099 | 724,437 |
| Supplies and communication | 533,883 | 552,350 |
| Assessment and administrative expense | 348,317 | 321,901 |
| Other operating expenses | 460,862 | 850,927 |
| Total noninterest expenses | 20,545,874 | 15,757,315 |
| Income before income taxes | 10,235,795 | 11,503,880 |
| Income taxes (note 7) | 4,079,018 | 4,265,627 |
| Net income | 6,156,777 | 7,238,253 |
| Other comprehensive income: | | |
| Unrealized gain (loss) on securities available for sale and interest-only strip arising during period | 188,622 | (937,010) |
| Income taxes on other comprehensive income (loss) | (75,166) | 347,442 |
| Other comprehensive income (loss), net of tax | 113,456 | (589,568) |
| Total comprehensive income | \$ 6,270,233 | 6,648,685 |
| Earnings per share (note 8): | | |
| Basic | \$ 0.58 | 0.70 |
| Diluted | 0.57 | 0.68 |
| Weighted average shares outstanding: | | |
| Basic | 10,632,160 | 10,295,324 |
| Diluted | 10,834,571 | 10,676,590 |

See accompanying notes to consolidated financial statements.

SAEHAN BANCORP AND SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity
Years ended December 31, 2006 and 2005

| | <u>Shares outstanding</u> | <u>Common stock</u> | <u>Additional paid-in capital</u> | <u>Retained earnings</u> | <u>Accumulated other comprehensive income (loss)</u> | <u>Total shareholders' equity</u> |
|--|-------------------------------|-------------------------|---|------------------------------|--|---|
| Balance at December 31, 2004 | 9,369,998 | \$ 33,165,404 | — | 4,432,997 | (93,280) | 37,505,121 |
| 5% stock dividend | 471,822 | 5,673,660 | — | (5,673,660) | — | — |
| Cash paid for fractional shares | — | — | — | (2,934) | — | (2,934) |
| Stock options exercised | 158,842 | 420,490 | — | — | — | 420,490 |
| Tax benefit of stock option exercise | — | — | 16,331 | — | — | 16,331 |
| Comprehensive income: | | | | | | |
| Net income | — | — | — | 7,238,253 | — | 7,238,253 |
| Change in unrealized loss on securities available for sale, net of tax | — | — | — | — | (579,053) | (579,053) |
| Change in unrealized gain on interest-only strip, net of tax | — | — | — | — | (10,515) | (10,515) |
| Total comprehensive income | | | | | | <u>6,648,685</u> |
| Balance at December 31, 2005 | 10,000,662 | 39,259,554 | 16,331 | 5,994,656 | (682,848) | 44,587,693 |
| 4% stock dividend | 409,370 | 6,590,857 | — | (6,590,857) | — | — |
| Cash paid for fractional shares | — | — | — | (2,026) | — | (2,026) |
| Stock options exercised | 253,020 | 732,751 | — | — | — | 732,751 |
| Tax benefit of stock option exercise | — | — | 23,512 | — | — | 23,512 |
| Share-based compensation cost | — | — | 1,070,681 | — | — | 1,070,681 |
| Comprehensive income: | | | | | | |
| Net income | — | — | — | 6,156,777 | — | 6,156,777 |
| Change in unrealized loss on securities available for sale, net of tax | — | — | — | — | 88,104 | 88,104 |
| Change in unrealized gain on interest-only strip, net of tax | — | — | — | — | 25,352 | 25,352 |
| Total comprehensive income | | | | | | <u>6,270,233</u> |
| Balance at December 31, 2006 | <u>10,663,052</u> | <u>\$ 46,583,162</u> | <u>1,110,524</u> | <u>5,558,550</u> | <u>(569,392)</u> | <u>52,682,844</u> |

See accompanying notes to consolidated financial statements.

SAEHAN BANCORP AND SUBSIDIARY

Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005

| | <u>2006</u> | <u>2005</u> |
|--|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 6,156,777 | 7,238,253 |
| Adjustments to reconcile net income to net cash and cash equivalents provided by operating activities: | | |
| Depreciation and amortization | 781,719 | 612,480 |
| Amortization (accretion) of discount and premium on securities available for sale, net | (2,349) | 9,326 |
| Share-based compensation expense | 1,070,681 | — |
| Provision for credit losses | 1,563,000 | 1,471,800 |
| FHLB stock dividends | (127,200) | (77,200) |
| Provision for deferred income tax | (723,304) | (722,451) |
| Loss on disposition of premise and equipment | 7,725 | 54,651 |
| Gain on sales of loans | (2,451,116) | (2,021,323) |
| Tax benefit from stock option exercise | 23,512 | 16,331 |
| Origination of loans identified as held for sale | (43,854,790) | 28,854,500 |
| Proceeds from sales of loans held for sale | 45,234,990 | (17,341,468) |
| Increase in accrued interest receivable | (595,576) | (1,107,657) |
| Increase in servicing asset | (68,764) | (58,613) |
| Decrease in other assets | 134,622 | 134,489 |
| Increase in accrued interest payable | 2,102,249 | 1,325,112 |
| Increase (decrease) in other liabilities | (241,311) | 2,194,324 |
| Net cash and cash equivalents provided by operating activities | <u>9,010,865</u> | <u>20,582,554</u> |
| Cash flows from investing activities: | | |
| Net increase in loans receivable | (103,656,853) | (135,639,256) |
| Purchases of securities available for sale | (5,583,325) | (25,546,706) |
| Proceeds from sale, matured, or called securities available for sale | 5,146,878 | 8,808,229 |
| Purchase of Federal Home Loan Bank Stock | (96,400) | (1,294,000) |
| Proceeds from sale of Federal Home Loan Bank Stock | 305,100 | — |
| Purchases of premise and equipment | (3,492,558) | (1,499,337) |
| Net cash and cash equivalents used in investing activities | <u>(107,377,158)</u> | <u>(155,171,070)</u> |
| Cash flows from financing activities: | | |
| Net increase in deposits | 100,211,556 | 118,789,427 |
| Increase (decrease) in federal fund purchased | (5,000,000) | 5,000,000 |
| Proceeds from other borrowed funds | 10,000,000 | 10,000,000 |
| Proceeds from exercise of stock options | 732,751 | 420,490 |
| Tax benefit from exercise of stock options | (23,512) | — |
| Stock dividend paid-in cash for fractional shares | (2,026) | (2,934) |
| Net cash and cash equivalents provided by financing activities | <u>105,918,769</u> | <u>134,206,983</u> |
| Net increase (decrease) in cash and cash equivalents | 7,552,476 | (381,533) |
| Cash and cash equivalents, beginning of year | <u>22,937,086</u> | <u>23,318,619</u> |
| Cash and cash equivalents, end of year | \$ <u>30,489,562</u> | <u>22,937,086</u> |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the year for: | | |
| Interest | \$ 19,833,207 | 7,444,117 |
| Income taxes | 4,842,032 | 4,572,511 |
| Noncash financing activities: | | |
| Transfer of retained earnings to common stock for stock dividend | \$ 6,590,856 | 5,673,660 |

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(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 eight branch offices in the Greater Los Angeles area and five 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 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 and to prevailing practices within the banking industry.

(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. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. The factors to consider in the estimation of credit losses included but are not limited to 1) changes in policies, underwriting standard, collection, and charge-off practices, 2) changes in economic conditions, 3) changes in nature and volume of loans, 4) changes in experience and ability of the lending management, 5) changes in trend delinquencies and classified assets, 6) changes in quality of loan review, 7) concentrations of credit, 8) the effects of transfer risk on international lending activities, and 9) the effect of external factors such as legal and regulatory requirements on the level of estimated credit losses in the institution's current portfolio. Such regulatory agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is possible that the allowance for loan losses may change materially in the near term.

(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 a one-day period.

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Notes to Consolidated Financial Statements

December 31, 2006 and 2005

(d) *Securities Available for Sale*

Investments 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. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. There were no trading or held-to-maturity securities at December 31, 2006 and 2005.

(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 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 they are specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. 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.

(f) *Allowance for Loan Losses*

The allowance for loan losses is maintained at a level which, in management’s judgment, is adequate to absorb credit losses inherent in the loan portfolio. The adequacy of the allowance is determined by management based upon an evaluation and review of the loan portfolio, consideration of historical loan loss experience, specific impaired loans, current economic conditions, changes in the composition of the loan portfolio, and other risk factors. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows.

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

December 31, 2006 and 2005

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

(g) *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 aggregate as determined by a fair value analysis we perform using prevailing market assumptions. 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 8.14%, and an average constant prepayment rate of 15.64% in 2005. During 2006, the discount rate was 1% above the main note rate, with an average discount rate of 8.15% and an average constant prepayment rate of 18.13%. The servicing asset is amortized in proportion to and over the period of estimated servicing income. The Bank has capitalized \$764,136 and \$439,581 of servicing assets and amortized \$448,507 and \$131,962 during the years ended December 31, 2006 and 2005, respectively. Management periodically evaluates the servicing assets for impairment. Impairment, if it occurs, is recognized in a valuation allowance in the period of impairment. For purposes of measuring impairment, the servicing assets are stratified by collateral type. No impairment existed at December 31, 2006 and 2005.

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.

(h) *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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December 31, 2006 and 2005

(i) *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 either be taxable or deductible when the assets and liabilities are recovered or settled.

(j) *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 \$2,558,700 at December 31, 2006. 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.

(k) *Stock Based Compensation*

We adopted SFAS No. 123(R), *Share-Based Payment*, 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 SFAS No. 123(R). 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 SFAS No. 123, *Accounting for Stock-Based Compensation*. Prior to the adoption of SFAS No. 123(R), we accounted for stock compensation under the intrinsic value method permitted by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, we 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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Had the Company determined compensation cost based on the fair value at the grant dates for its stock options using the fair value method of SFAS No. 123, the Company's net income and earnings per share for the years ended December 31, 2005 would have been reduced to the pro forma amounts indicated in the following table:

| | 2005 |
|--|--------------|
| Net income, as reported: | |
| As reported | \$ 7,238,253 |
| Add stock-based employee compensation expense included in reported net income, net of related tax effects | — |
| Deduct total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (419,035) |
| Pro forma net income | \$ 6,819,218 |
| Earnings per share: | |
| As reported: | |
| Basic | \$ 0.70 |
| Diluted | 0.68 |
| Pro forma: | |
| Basic | 0.66 |
| Diluted | 0.64 |

The weighted average fair value of options granted under the Company's stock option plans was \$11.59 per share in 2005. The weighted average fair value of options granted was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumption: no cash dividend yield, expected volatility of 29.31%, expected lives of three to five years, and average risk-free interest rate of 3.54%.

In November 2005, the Financial Accounting Standards Board (FASB) issued Staff Position No. FAS 123R-3, *Transition Election Related to Accounting for the Tax Effects of the Share-Based Payment Awards* (FAS 123R-3). We have adopted the alternative transition method prescribed by FAS 123R-3 and concluded that we have no pool of tax benefits as of the adoption date of SFAS No. 123(R).

SFAS No. 123(R) 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 SFAS No. 123(R) be classified as a financing cash inflow and an operating cash outflow in the consolidated statements of cash flows. Before the adoption of SFAS No. 123(R), we presented all tax benefits realized from the exercise of stock options as an operating cash inflow.

(I) 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.

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(m) *Reclassification*

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

(n) *Segment Reporting*

Through its seven branches network, the Company provides a broad range of financial services to individuals and companies located in 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 Company-wide basis. Accordingly, the Company considers all of its operations are aggregated in one reportable operating segment.

(o) *Recent Accounting Pronouncements*

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within that fiscal year. We are currently assessing the impact that the adoption of SFAS No. 157 will have on our financial condition and results of operations.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 (FIN No. 48)*. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We will be required to adopt FIN No. 48 in the fiscal year beginning January 1, 2007. We do not expect the adoption of FIN No. 48 will have a material effect on our financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*, which amends the guidance in SFAS No. 140. SFAS No. 156 requires that an entity separately recognize a servicing asset or a servicing liability when it undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be measured initially at fair value, if practicable. SFAS No. 156 also allows an entity to measure its servicing assets and servicing liabilities subsequently using either the amortization method, which existed under SFAS No. 140, or the fair value measurement method. SFAS No. 156 will be effective in the fiscal year beginning January 1, 2007. The Company does not expect the adoption of SFAS No. 156 to have a material impact on our financial condition or results of operations.

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In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and SFAS No. 140* (SFAS No. 155). This Statement:

- permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation
- clarifies which interest-only strips and principal-only strips are not subject to SFAS No. 133
- establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation
- clarifies that concentration of credit risks in the form of subordination are not embedded derivatives
- amends SFAS No. 140 to eliminate the prohibition on a QSPE from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of SFAS No. 155 to have a material impact on our financial condition or results of operations.

(2) Securities Available for Sale

The following is a summary of securities available for sale at December 31, 2006 and 2005:

| | <u>Amortized cost</u> | <u>Gross unrealized gain</u> | <u>Gross unrealized loss</u> | <u>Estimated fair value</u> |
|--|---------------------------|--------------------------------------|--------------------------------------|---------------------------------|
| 2006: | | | | |
| U.S. government-sponsored entity securities | \$ 20,946,824 | — | 347,298 | 20,599,526 |
| Municipal bonds | 12,204,241 | 32,272 | 152,425 | 12,084,088 |
| Mortgage-backed securities | 23,558,390 | 3,633 | 608,605 | 22,953,418 |
| FNMA preferred stock | 360,000 | 67,500 | — | 427,500 |
| Total | <u>\$ 57,069,455</u> | <u>103,405</u> | <u>1,108,328</u> | <u>56,064,532</u> |
| 2005: | | | | |
| U.S. government-sponsored entity securities | \$ 21,426,985 | 130 | 356,984 | 21,070,131 |
| Municipal bonds | 8,102,696 | 8,298 | 146,812 | 7,964,182 |
| Mortgage-backed securities | 26,740,979 | — | 701,658 | 26,039,321 |
| FNMA preferred securities | 360,000 | 40,000 | — | 400,000 |
| Total | <u>\$ 56,630,660</u> | <u>48,428</u> | <u>1,205,454</u> | <u>55,473,634</u> |

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Accrued interest and dividends receivable on investment securities totaled \$437,764 and \$408,397 at December 31, 2006 and 2005, respectively.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows as of December 31, 2006:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---------------------|------------|-------------------|------------|-------------------|------------|
| | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value |
| U.S. government-sponsored entity securities | \$ — | — | 347,298 | 20,599,526 | 347,298 | 20,599,526 |
| Municipal bonds | 96,208 | 6,938,464 | 56,217 | 2,423,557 | 152,425 | 9,362,021 |
| Mortgage-backed securities | — | — | 608,605 | 21,504,079 | 608,605 | 21,504,079 |
| Total | \$ 96,208 | 6,938,464 | 1,012,120 | 44,527,162 | 1,108,328 | 51,465,626 |

All individual securities that have been in a continuous unrealized loss position for 12 months or longer at December 31, 2006 had investment grade ratings upon purchase. The issuers of these securities have not, to our 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, 2006. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated. However, the Company has the ability and management intends to hold these securities until their fair values recover to cost. Therefore, in management's opinion, all securities that have been in a continuous unrealized loss position for the past 12 months or longer as of December 31, 2006 are not other-than-temporarily impaired, and therefore, no impairment charges as of December 31, 2006 are warranted.

The amortized cost and estimated fair value of securities available for sale at December 31, 2006, 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.

| | Amortized cost | Estimated fair value |
|---|----------------|----------------------|
| Due after three months through one year | \$ 500,000 | 490,125 |
| Due after one year through five years | 30,282,607 | 29,690,502 |
| Due after five years through ten years | 13,960,884 | 13,723,514 |
| Due after ten years | 11,965,873 | 11,732,891 |
| FNMA preferred stock | 360,000 | 427,500 |
| Total | \$ 57,069,364 | 56,064,532 |

Securities with amortized cost of approximately \$37,558,600 and \$40,559,600 at December 31, 2006 and 2005, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

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(3) Loans Receivable and Allowance for Credit Losses

The following is a summary of loans by major categories at December 31, 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|---------------------------------|-----------------------|--------------------|
| Real estate loans | \$ 352,884,091 | 259,387,293 |
| Construction loans | 7,970,775 | 4,863,066 |
| Commercial loans | 149,751,336 | 158,981,846 |
| Consumer loans | <u>21,301,502</u> | <u>5,149,341</u> |
| Total | 531,907,704 | 428,381,546 |
| Less: | | |
| Deferred loan costs (fees), net | 25,658 | (576,746) |
| Unearned income | (2,043,473) | (1,937,116) |
| Allowance for loan losses | <u>(5,477,827)</u> | <u>(4,687,276)</u> |
| Net loans | \$ <u>524,412,062</u> | <u>421,180,408</u> |

As of December 31, 2006 and 2005, the Company serviced loans sold to unaffiliated parties in the amount of approximately \$80,779,000 and \$61,832,000, respectively.

An analysis of the activity in the allowance for loan losses and reserve for off-balance credit risk for the years ended December 31, 2006 and 2005 is as follow:

| | <u>2006</u> | <u>2005</u> |
|-----------------------------|---------------------|------------------|
| Balance, beginning of year | \$ 4,807,276 | 3,539,400 |
| Provision for credit losses | 1,563,000 | 1,471,800 |
| Loan recoveries | 191,036 | 427,650 |
| Loans charged off | <u>(766,485)</u> | <u>(631,574)</u> |
| Balance, end of year | \$ <u>5,794,827</u> | <u>4,807,276</u> |

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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At December 31, 2006 and 2005, the Company's impaired loans were \$5,527,951 and \$4,174,215, respectively, and its impairment reserves of approximately \$150,000 and \$175,000, respectively. Interest income of \$419,500 and \$351,000 was recognized on impaired loans during the years ended December 31, 2006 and 2005, respectively. Loans on which the accrual of interest has been discontinued amounted to \$1,502,117 and \$622,311 at December 31, 2006 and 2005, respectively. If interest on these loans had been accrued, interest income would have increased by approximately \$115,900 in 2006 and \$72,000 in 2005. Restructured loans totaled \$836,000 and \$207,800 at December 31, 2006 and 2005, respectively. The following table provides information of the Company's nonaccrual loans as of December 31, 2006 and 2005.

| | <u>2006</u> | <u>2005</u> |
|---------------------------------|---------------------|----------------|
| Real estate loans | \$ 263,953 | 166,684 |
| Commercial and industrial loans | 1,201,624 | 455,627 |
| Consumer loans | 36,540 | — |
| Total nonaccrual loans | <u>\$ 1,502,117</u> | <u>622,311</u> |

The Company is not committed to lend additional funds to debtors whose loans are considered to be impaired.

(4) Premises and Equipment

Premises and equipment at December 31, 2006 and 2005 consisted of the following:

| | <u>2006</u> | <u>2005</u> |
|------------------------------------|---------------------|--------------------|
| Land | \$ 336,116 | 336,116 |
| Leasehold improvements | 4,566,444 | 2,721,891 |
| Equipment, furniture, and fixtures | 3,820,298 | 2,507,774 |
| Computer software | 578,302 | 421,704 |
| Total | 9,301,159 | 5,987,485 |
| Less accumulated depreciation | <u>(3,148,177)</u> | <u>(2,537,616)</u> |
| Premise and equipment, net | <u>\$ 6,152,983</u> | <u>3,449,869</u> |

Total depreciation and amortization included in occupancy and equipment expenses was \$781,719 and \$612,480 for the years ended December 31, 2006 and 2005, respectively.

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(5) Deposits

The scheduled maturities of time deposits were as follows at December 31, 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|----------------------------|-----------------------|--------------------|
| 3 months or less | \$ 126,420,625 | 111,781,689 |
| Over 3 months to 12 months | 143,385,063 | 94,057,374 |
| Over 12 months | <u>2,787,532</u> | <u>696,558</u> |
| Total | <u>\$ 272,593,220</u> | <u>206,535,621</u> |

A summary of interest expense related to deposits and other borrowings is as follows for the years ended December 31, 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|--------------------------------|----------------------|------------------|
| Interest-bearing demand | \$ 24,165 | 30,518 |
| Money market funds and savings | 3,651,476 | 2,414,269 |
| Time deposits: | | |
| \$100,000 or more | 10,250,728 | 4,301,196 |
| Other time deposits | 2,390,330 | 686,533 |
| Other | <u>1,414,258</u> | <u>1,336,713</u> |
| Total | <u>\$ 17,730,957</u> | <u>8,769,229</u> |

(6) Other Borrowed Funds

The Company has a line of credit with the FHLB in the amount of \$151,111,137, which is \$128,482,698 of the standard credit program and \$22,628,439 of the securities-backed credit program. At December 31, 2006, the outstanding amount of the line of credit was \$47,000,000, with maturities within 5 years. The interest rates range from 4.92% to 5.40%.

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(7) Income Taxes

The provisions for income taxes for the years ended December 31, 2006 and 2005 are summarized as follows:

| | <u>2006</u> | <u>2005</u> |
|------------------------------|---------------------|------------------|
| Current income tax expense: | | |
| Federal | \$ 3,939,592 | 3,982,647 |
| State | 862,730 | 1,005,431 |
| Total | <u>4,802,322</u> | <u>4,988,078</u> |
| Deferred income tax benefit: | | |
| Federal | (534,514) | (564,614) |
| State | (188,790) | (157,837) |
| Total | <u>(723,304)</u> | <u>(722,451)</u> |
| Income taxes | \$ <u>4,079,018</u> | <u>4,265,627</u> |

As of December 31, 2006 and 2005, deferred income tax liabilities have been provided for taxable temporary differences, and deferred income tax assets have been provided for deductible temporary differences. The net deferred income tax assets included in the consolidated statements of financial condition include the following components:

| | <u>2006</u> | <u>2005</u> |
|--|---------------------|------------------|
| Allowance for loan losses | \$ 2,138,783 | 1,738,822 |
| Accumulated depreciation | 167,814 | 4,093 |
| Unrealized loss on available-for-sale securities | 399,459 | 481,480 |
| State taxes | 99,929 | 201,200 |
| Share-based compensation expense | 229,233 | — |
| Other | 129,775 | 98,114 |
| Net deferred income tax assets | \$ <u>3,164,993</u> | <u>2,523,709</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 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.

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

| | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|
| Federal income tax at statutory tax rate | 34% | 34% |
| Net state income tax | 5 | 5 |
| Other | 1 | (2) |
| | <u>40%</u> | <u>37%</u> |

At December 31, 2006 and 2005, income tax payable of \$107,685 and \$147,395 were included in other liabilities, respectively, in the consolidated statements of financial condition.

(8) Earnings per Share

The EPS data for 2005 was retroactively restated reflecting the 2006 stock dividend of 4%. The following is a reconciliation of the numerators and denominators of the basic and diluted per share computations at December 31, 2006 and 2005:

| | <u>Income (numerator)</u> | <u>Weighted shares (denominator)</u> | <u>Per share amount</u> |
|---|-------------------------------|--|-----------------------------|
| 2006: | | | |
| Basic EPS – income available to common shareholders | \$ 6,156,777 | 10,632,160 | \$ 0.58 |
| Effect of dilutive securities: | | | |
| Stock options assumed exercised | <u>—</u> | <u>202,411</u> | <u>0.01</u> |
| Diluted EPS – income available to common shareholders | <u>\$ 6,156,777</u> | <u>10,834,571</u> | <u>\$ 0.57</u> |
| 2005: | | | |
| Basic EPS – income available to common shareholders | \$ 7,238,252 | 10,295,324 | \$ 0.70 |
| Effect of dilutive securities: | | | |
| Stock options assumed exercised | <u>—</u> | <u>381,266</u> | <u>0.02</u> |
| Diluted EPS – income available to common shareholders | <u>\$ 7,238,252</u> | <u>10,676,590</u> | <u>\$ 0.68</u> |

(9) 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.

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The following summarizes the activities during 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|------------------------------|---------------------|--------------------|
| Balance at beginning of year | \$ 4,598,064 | 4,109,815 |
| New loans granted | 116,697 | 4,189,267 |
| Principal repayments | <u>(2,675,311)</u> | <u>(3,701,018)</u> |
| Balance at end of year | \$ <u>2,039,450</u> | <u>4,598,064</u> |

(10) 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 leases approximated the following amounts:

| | <u>Amount</u> |
|--------------------------|----------------------|
| Year ending December 31: | |
| 2007 | \$ 1,844,057 |
| 2008 | 1,834,713 |
| 2009 | 1,738,265 |
| 2010 | 1,748,859 |
| 2011 | 1,632,827 |
| Thereafter | <u>3,315,466</u> |
| Total | \$ <u>12,114,187</u> |

The total rental expense recorded under such leases for 2006 and 2005 amounted to approximately \$1,553,900 and \$1,240,000, respectively.

(11) Off-Balance-Sheet Credit Risk

In the normal course of meeting the financing instruments 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, we receive 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, 2006 and 2005, the Company had loan commitments granted and undisbursed of \$84,007,190, and \$61,013,072, and commitments under outstanding commercial letters of credit of \$9,248,823, and \$11,194,157 at December 31, 2006 and 2005, respectively. Standby letters of credit and guarantees of \$1,912,362, and \$1,922,827 at December 31, 2006

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and 2005, respectively. Management does not anticipate any material losses as a result of these transactions.

(12) 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, 2006. There is the 1998 Stock Option Plan (1998 Plan), the 2004 Stock Option Plan (2004 Plan) and the 2006 Stock Option Plan (2006 Plan).

1998 Stock Option Plan

The 1998 Plan provides that the total numbers of option shares that can be granted are 2,305,824 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 ten years. There were no options granted under the 1998 Plan in 2006 and 2005.

The following is a summary of the 1998 Plan transactions for the year ended December 31, 2006 and 2005:

| | 2006 | | 2005 | |
|---|---------------------------------|--|---------------------------------|--|
| | Number of shares | Exercise price per shares | Number of shares | Exercise price per shares |
| Options outstanding – beginning of year | 283,268 | \$ 2.64 | 477,698 | \$ 8.64 |
| Options exercised | (242,027) | 2.33 | (158,842) | 3.67 |
| Options forfeited | <u>(5,286)</u> | 5.12 | <u>(35,588)</u> | 22.20 |
| Options outstanding – end of year | <u>35,955</u> | 4.36 | <u>283,268</u> | 2.67 |
| Options exercisable – end of year | 35,955 | 4.36 | 241,124 | 2.46 |

For the year ended December 31, 2006, compensation expense of \$15,704 for the 1998 Stock Option Plan was recognized in the consolidated statement of income.

The following information under the 1998 Stock Option Plan is presented for the years ended December 31, 2006 and 2005.

| | Year ended December 31, | |
|--|--------------------------------|-------------|
| | 2006 | 2005 |
| Grant date fair value of options granted | \$ — | — |
| Fair value of options vested | 15,704 | 11,125 |
| Total intrinsic value of options exercised | 3,763,862 | 1,722,112 |
| Cash received from options exercised | 579,417 | 420,490 |
| Actual tax benefit realized from tax deductions on options exercised | — | 16,331 |

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As of December 31, 2006, stock options outstanding under the 1998 Stock Option 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 |
| \$0.00 through \$3.249 | — | \$ — | — | — | 3,567 | \$ 47,691 | 2.63 | 5.00 |
| \$3.25 through \$5.249 | 35,955 | 418,516 | 4.36 | 1.76 | 35,955 | 418,516 | 4.36 | 1.76 |
| | <u>35,955</u> | <u>\$ 418,516</u> | <u>4.36</u> | <u>1.76</u> | <u>39,522</u> | <u>\$ 466,207</u> | <u>4.21</u> | <u>2.06</u> |

2004 Stock Option Plan

The 2004 Plan provides that the total numbers of option shares that can be granted are 1,092,000 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 ten years.

For the year ended December 31, 2006 and 2005, the estimated weighted average fair value per share of options granted under the 2004 Plan was as follows:

| | <u>Year ended December 31,</u> | |
|--|--------------------------------|-------------|
| | <u>2006</u> | <u>2005</u> |
| Estimated weighted average fair value per share of options granted | \$ 4.32 | 5.24 |

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:

| | <u>Year ended December 31,</u> | |
|-------------------------------------|--------------------------------|-------------|
| | <u>2006</u> | <u>2005</u> |
| Weighted average assumptions: | | |
| Expected volatility | 25.08% | 29.55% |
| Expected term | 3.0 years | 5.0 years |
| Risk-free interest rate | 4.54% | 4.24% |
| Expected prevesting forfeiture rate | 3.56% | 3.56% |

Expected volatility is determined based 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.

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The following information under the 2004 Stock Option Plan is presented for the years ended December 31, 2006 and 2005.

| | Year ended December 31, | |
|--|--------------------------------|-------------|
| | 2006 | 2005 |
| Grant date fair value of options granted | \$ 899,184 | 1,318,966 |
| Fair value of options vested | 973,203 | 505,196 |
| Total intrinsic value of options exercised | 65,066 | — |
| Cash received from options exercised | 153,334 | — |
| Actual tax benefit realized from tax deductions on options exercised | 23,512 | — |

The following is a summary of the stock option activity during 2006 under the 2004 Stock Option Plan:

| | 2006 | | 2005 | |
|---|-------------------------|----------------------------------|-------------------------|----------------------------------|
| | Number of shares | Exercise price per shares | Number of shares | Exercise price per shares |
| Options outstanding – beginning of year | 829,764 | \$ 10.72 | 577,914 | \$ 8.50 |
| Options granted | 208,000 | 19.23 | 251,850 | 11.62 |
| Options exercised | (14,560) | 10.53 | — | — |
| Options forfeited | (29,120) | 10.53 | — | — |
| Options outstanding – end of year | <u>994,084</u> | 12.51 | <u>829,764</u> | 10.72 |
| Options exercisable – end of year | 401,823 | 10.61 | 182,000 | 10.95 |

For the year ended December 31, 2006, compensation expense of \$973,203 for the 2004 Stock Option Plan was recognized in the consolidated statement of income.

As of December 31, 2006, stock options outstanding under the 2004 Stock Option 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 |
| \$10.00 through \$10.99 | 681,408 | \$ 3,672,789 | \$ 10.61 | 7.13 | 380,889 | \$ 2,072,036 | 10.56 | 7.69 |
| \$11.00 through \$11.99 | 104,676 | 467,902 | 11.53 | 4.76 | 20,934 | 93,575 | 11.53 | 4.76 |
| \$19.00 through \$19.99 | 208,000 | (671,840) | 19.23 | 9.17 | — | — | — | — |
| | <u>994,084</u> | <u>\$ 3,468,851</u> | <u>\$ 12.51</u> | <u>7.31</u> | <u>401,823</u> | <u>\$ 2,165,611</u> | <u>10.61</u> | <u>7.54</u> |

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2006 Stock Option Plan

The 2006 Plan provides that the total numbers of option shares that can be granted are 520,000 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 ten years.

For the year ended December 31, 2006, the estimated weighted average fair value per share of options granted under the 2006 Stock Option Plan was as follows:

| | | |
|--|----|------|
| Estimated weighted average fair value per share of options granted | \$ | 5.47 |
|--|----|------|

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:

| | <u>December 31,</u> <u>2006</u> |
|-------------------------------------|------------------------------------|
| Weighted average assumptions: | |
| Expected volatility | 27.61% |
| Expected term | 5.0 |
| Risk-free interest rate | 4.93% |
| Expected prevesting forfeiture rate | 3.56% |

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 Stock Option Plan is presented for the year ended December 31, 2006.

| | | |
|--|----|---------|
| Grant date fair value of options granted | \$ | 885,367 |
| Fair value of options vested | | 81,773 |
| 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 2006 under the 2006 Stock Option Plan:

| | December 31, 2006 | |
|---|---------------------------------|--|
| | Number of shares | Exercise price per shares |
| Options outstanding – beginning of year | — | \$ — |
| Options granted | 161,800 | 16.30 |
| Options outstanding – end of year | <u>161,800</u> | 16.30 |
| Options exercisable – end of year | — | — |

For the year ended December 31, 2006, compensation expense of \$81,773 for the 2006 Stock Option Plan was recognized in the consolidated statement of income.

As of December 31, 2006, stock options outstanding under the 2006 Stock Option Plan were as follows:

| | Options outstanding | | | Weighted average remaining contractual life |
|-------------------------|---------------------------------|----------------------------|---|--|
| | Number of shares | Intrinsic value | Average exercise price per share | |
| \$15.00 through \$16.99 | 83,200 | \$ 38,272 | 15.54 | 5.54 |
| \$17.00 through \$18.99 | 78,600 | (86,460) | 17.10 | 5.67 |
| | <u>161,800</u> | <u>\$ (48,188)</u> | <u>16.30</u> | <u>5.60</u> |

(13) Employee Benefit Plans

The Company has a 401(k) plan for the benefit of its employees. The Company matches 100% of the employees' contribution up to 5% of each participant's annual compensation. Contributions to the plan for the years ended December 31, 2006 and 2005 were approximately \$157,000 and \$120,000, respectively.

(14) Fair Value of Financial Instruments

The Company estimated 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.

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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.

| | <u>Carrying amount</u> | <u>Estimated fair value</u> |
|---|----------------------------|---------------------------------|
| 2006: | | |
| Cash and cash equivalents | \$ 30,489,562 | 30,489,562 |
| Securities available for sale | 56,064,533 | 56,064,533 |
| Net loans | 523,341,146 | 528,162,404 |
| Loans held for sale, at the lower of cost or fair value | 1,070,916 | 1,070,916 |
| Accrued interest receivable | 2,863,278 | 2,863,278 |
| Federal Home Loan Bank stock | 2,558,700 | 2,558,700 |
| Deposits | 520,551,579 | 520,551,579 |
| Other borrowed funds | 47,000,000 | 46,988,726 |
| Accrued interest payable | 3,918,807 | 3,918,807 |
| 2005: | | |
| Cash and cash equivalents | \$ 22,937,086 | 22,937,086 |
| Securities available for sale | 55,473,634 | 55,473,634 |
| Net loans | 421,180,408 | 422,497,042 |
| Accrued interest receivable | 2,267,702 | 2,267,702 |
| FHLB stock | 2,640,200 | 2,640,200 |
| Deposits | 420,340,023 | 420,340,023 |
| Federal funds purchased | 5,000,000 | 5,000,000 |
| Other borrowed funds | 37,000,000 | 37,000,000 |
| Accrued interest payable | 1,816,558 | 1,816,558 |

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) Securities Available for Sale

Fair values of securities available for sale are based on quoted market prices, if available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

(c) Net Loans, Loans Held for Sale, and Accrued Interest Receivable

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 experience and risk characteristics. The estimated fair value is net of allowance for loan losses.

(d) *Accrued Interest Receivable and Federal Home Loan Bank Stock*

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

(e) *Deposits, Federal Funds Purchased, and Accrued Interest Payable*

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

(f) *Other Borrowed Funds*

Discount cash flows have been used to value FHLB advances.

(g) *Commitment to Extend Credit, Letters of Credit, and Standby Letter of Credit*

The majority of the Company's commitments to extend credit carries current market interest rates if converted to loans. Because these commitments are generally unassignable by either the borrower or the Company, they only have value to the borrower and the Company. The fair value of letters of credit was based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The estimated fair value of these off-balance-sheet commitments are excluded from the above table because it is not material.

(15) Regulatory Matters

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 (as defined). Management believes that, as of December 31, 2006, the Bancorp and the Bank meet all capital adequacy requirements to which they are subject.

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Notwithstanding the above regulatory remark, the Bancorp and Bank's actual capital amounts and ratios are as follows at December 31, 2006 and 2005:

| | <u>Actual</u> | | <u>For capital adequacy purpose</u> | | <u>To be well capitalized under prompt corrective action provision</u> | |
|---|------------------------|--------------|-------------------------------------|--------------|--|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| | (Dollars in thousands) | | | | | |
| 2006: | | | | | | |
| Total capital (to risk-weighted assets): | | | | | | |
| Bancorp | \$ 59,031 | 10.7% | \$ 44,334 | 8.0% | \$ — | N/A |
| Bank | 57,986 | 10.7 | 43,412 | 8.0 | 54,265 | 10.0 |
| Tier I capital (to risk-weighted assets): | | | | | | |
| Bancorp | 53,205 | 9.6 | 22,167 | 4.0 | — | N/A |
| Bank | 52,160 | 9.6 | 21,706 | 4.0 | 32,559 | 6.0 |
| Tier I capital (to average assets): | | | | | | |
| Bancorp | 53,205 | 8.8 | 24,218 | 4.0 | — | N/A |
| Bank | 52,160 | 8.6 | 24,213 | 4.0 | 30,266 | 5.0 |

| | <u>Actual</u> | | <u>For capital adequacy purpose</u> | | <u>To be well capitalized under prompt corrective action provision</u> | |
|---|------------------------|--------------|-------------------------------------|--------------|--|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| | (Dollars in thousands) | | | | | |
| 2005: | | | | | | |
| Total capital (to risk-weighted assets): | | | | | | |
| Bancorp | \$ 49,961 | 11.4% | \$ 35,011 | 8.0% | \$ — | N/A |
| Bank | 49,729 | 11.4 | 35,011 | 8.0 | 43,764 | 10.0 |
| Tier I capital (to risk-weighted assets): | | | | | | |
| Bancorp | 45,136 | 10.3 | 17,505 | 4.0 | — | N/A |
| Bank | 44,904 | 10.3 | 17,505 | 4.0 | 26,258 | 6.0 |
| Tier I capital (to average assets): | | | | | | |
| Bancorp | 45,136 | 9.0 | 20,117 | 4.0 | — | N/A |
| Bank | 44,904 | 8.9 | 20,117 | 4.0 | 25,146 | 5.0 |

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(16) Condensed Financial Statements of Parent Company

The following presents the unconsolidated condensed financial statements of the parent company, Saehan Bancorp, as of December 31, 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|--|----------------------|-------------------|
| Statements of financial condition: | | |
| Assets: | | |
| Cash and cash equivalents | \$ 865,797 | 232,179 |
| Investment in Saehan Bank | 51,638,259 | 44,355,527 |
| Deferred income tax asset | 200,995 | — |
| Total assets | <u>\$ 52,705,051</u> | <u>44,587,706</u> |
| Liabilities and shareholders' equity: | | |
| Other liabilities | \$ 22,207 | 13 |
| Shareholders' equity | 52,682,844 | 44,587,693 |
| Total liabilities and shareholders' equity | <u>\$ 52,705,051</u> | <u>44,587,706</u> |
| Statements of income: | | |
| Other operating expense | \$ (1,330,187) | (39,448) |
| Equity in net income of Saehan Bank | 7,169,277 | 7,261,701 |
| Income tax benefit | 317,687 | 16,000 |
| Net income | <u>\$ 6,156,777</u> | <u>7,238,253</u> |

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| | <u>2006</u> | <u>2005</u> |
|--|-------------------|--------------------|
| Statements of cash flows: | | |
| Cash flows from operating activities: | | |
| Net income | \$ 6,156,777 | 7,238,253 |
| Adjustments to reconcile net income to net cash and cash equivalents used in operating activities: | | |
| Equity in net income of Saehan Bank | (7,169,277) | (7,261,701) |
| Share-based compensation expense | 1,070,681 | — |
| Increase in deferred tax asset | (200,995) | — |
| Increase in other liabilities | 22,195 | 1 |
| Tax benefit from stock option exercise | 23,512 | 16,331 |
| Net cash and cash equivalents used in operating activities | <u>(97,107)</u> | <u>(7,116)</u> |
| Cash flows from investing activities: | | |
| Payments for investments in subsidiary | <u>—</u> | <u>(5,310,000)</u> |
| Net cash and cash equivalents used in investing activities | <u>—</u> | <u>(5,310,000)</u> |
| Cash flows from financing activities: | | |
| Proceeds from exercise of options | 732,751 | 420,490 |
| Stock dividend paid-in cash for fractional shares | <u>(2,026)</u> | <u>(2,934)</u> |
| Net cash and cash equivalents provided by financing activities | <u>730,725</u> | <u>417,556</u> |
| Net (decrease) increase in cash and cash equivalents | 633,618 | (4,899,560) |
| Cash and cash equivalents, beginning of year | <u>232,179</u> | <u>5,131,739</u> |
| Cash and cash equivalents, end of year | <u>\$ 865,797</u> | <u>232,179</u> |