HANMI FINANCIAL CORP
Form 10-Q
November 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014

or

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

For the Transition Period From __________ To __________

Commission File Number: 000-30421

HANMI FINANCIAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware	**95-4788120**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
3660 Wilshire Boulevard, Penthouse Suite A Los Angeles, California	**90010**
(Address of Principal Executive Offices)	**(Zip Code)**

(213) 382-2200

(Registrant s Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer	¨	Accelerated Filer	x
Non-Accelerated Filer	¨ (Do Not Check if a Smaller Reporting Company)	Smaller Reporting Company	¨

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

As of October 31, 2014, there were 31,904,031 outstanding shares of the Registrant s Common Stock.

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Quarterly Report on Form 10-Q

Three and Nine Months Ended September 30, 2014

Table of Contents

2

Table of Contents

Part I Financial Information

Item 1. Financial Statements

Hanmi Financial Corporation and Subsidiaries

Consolidated Balance Sheets (Unaudited)

(In thousands, except share data)

	September 30, 2014	December 31, 2013
Assets		
Cash and cash equivalents	$ 197,016	$ 179,357
Securities available for sale, at fair value (amortized cost of $1,139,173 as of September 30, 2014 and $549,113 as of December 31, 2013)	1,128,624	530,926
Loans held for sale, at the lower of cost or fair value	7,757	
Loans receivable, net of allowance for loan losses of $51,179 as of September 30, 2014 and $57,555 as of December 31, 2013	2,628,091	2,177,498
Accrued interest receivable	9,880	7,055
Premises and equipment, net	31,187	14,221
Other real estate owned, net	24,781	756
Customers liability on acceptances	2,428	2,018
Servicing assets	7,844	6,833
FDIC loss sharing asset	7,696	
Other intangible assets, net	2,179	1,171
Investment in federal home loan bank stock, at cost	17,579	14,060
Investment in federal reserve bank stock, at cost	12,273	11,196
Income tax assets	72,330	63,841
Bank-owned life insurance	48,670	29,699
Prepaid expenses	2,753	1,415
Other assets	27,244	14,333
Total assets	**$ 4,228,332**	**$ 3,054,379**
Liabilities and Stockholders Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	$ 1,029,343	$ 819,015
Interest-bearing	2,568,811	1,693,310
Total deposits	3,598,154	2,512,325
Accrued interest payable	3,030	3,366
Bank s liability on acceptances	2,428	2,018

Federal home loan bank advances	110,000	127,546
Rescinded stock obligation	15,720	
Subordinated debentures	18,509	
Accrued expenses and other liabilities	45,297	9,047
Total liabilities	**3,793,138**	**2,654,302**
Stockholders equity:		
Common stock, $0.001 par value; authorized 62,500,000 shares; issued 32,472,323 shares (31,894,429 shares outstanding) as of September 30, 2014 and 32,339,444 shares (31,761,550 shares outstanding) as of December 31, 2013	257	257
Additional paid-in capital	554,446	552,270
Accumulated other comprehensive loss, net of tax benefit of $5,469 as of September 30, 2014 and $8,791 as of December 31, 2013	(5,065)	(9,380)
Accumulated deficit	(44,586)	(73,212)
Less: treasury stock, at cost; 577,894 shares as of September 30, 2014 and December 31, 2013	(69,858)	(69,858)
Total stockholders equity	**435,194**	**400,077**
Total liabilities and stockholders equity	**$ 4,228,332**	**$ 3,054,379**

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

3

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Consolidated Statements of Income (Unaudited)

(In thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Interest and Dividend Income:				
Interest and fees on loans	$ 30,499	$ 29,098	$ 87,044	$ 83,736
Taxable interest on investment securities	3,138	2,040	8,050	6,256
Tax-exempt interest on investment securities	20	69	116	237
Interest on federal funds sold				6
Interest on interest-bearing deposits in other banks	29	28	67	140
Dividends on federal reserve bank stock	173	198	513	577
Dividends on federal home loan bank stock	290	194	762	449
Total interest and dividend income	34,149	31,627	96,552	91,401
Interest Expense:				
Interest on deposits	3,278	3,117	9,653	9,376
Interest on federal home loan bank advances	37	36	116	115
Interest on subordinated debentures	73		73	678
Interest on rescinded stock obligation	87		87	
Total interest expense	3,475	3,153	9,929	10,169
Net interest income before provision for credit losses	30,674	28,474	86,623	81,232
Negative provision for credit losses			(7,166)	
Net interest income after provision for credit losses	30,674	28,474	93,789	81,232
Noninterest Income:				
Bargain purchase gain, net of deferred taxes	6,593		6,593	
Service charges on deposit accounts	2,883	2,730	7,924	8,662
Remittance fees	459	481	1,388	1,519
Trade finance fees	314	248	873	801
Other service charges and fees	380	349	1,080	1,082
Bank-owned life insurance income	225	230	672	693
Gain on sales of SBA loans guaranteed portion	1,221	994	2,267	6,064
Net loss on sales of other loans				(557)

Net gain on sales of investment securities		67		611		1,852		923
Other operating income		2,179		416		2,588		758
Total noninterest income		14,321		6,059		25,237		19,945
Noninterest Expense:								
Salaries and employee benefits		12,847		9,101		33,386		26,126
Occupancy and equipment		3,098		2,561		7,964		7,532
Merger and integration costs		3,415				3,572		
Unconsummated acquisition costs				307				1,331
Deposit insurance premiums and regulatory assessments		513		308		1,349		1,059
Data processing		1,476		1,146		3,746		3,436
Other real estate owned expense		78		(59)		84		(47)
Professional fees		1,386		599		2,786		4,095
Directors and officers liability insurance		191		219		574		657
Supplies and communications		628		533		1,725		1,593
Advertising and promotion		809		1,039		2,142		2,419
Loan-related expense		58		91		203		328
Amortization of other intangible assets		33				33		
Other operating expenses		2,231		1,791		6,031		5,369
Total noninterest expense		26,763		17,636		63,595		53,898
Income from continuing operations before provision for income taxes		18,232		16,897		55,431		47,279
Provision for income taxes		4,968		6,582		19,667		17,510
Income from continuing operations, net of taxes	**$**	**13,264**	**$**	**10,315**	**$**	**35,764**	**$**	**29,769**
Discontinued operations								
Income from operations of discontinued subsidiaries (including gain on disposal of $51 in the second quarter of 2014)	$		$	112	$	37	$	242
Income tax expense				42		481		81
Income (loss) from discontinued operations				70		(444)		161
Net income	**$**	**13,264**	**$**	**10,385**	**$**	**35,320**	**$**	**29,930**
Basic earnings per share:								
Income from continuing operations, net of taxes	$	0.42	$	0.33	$	1.13	$	0.94
Income from discontinued operations, net of taxes						(0.02)		0.01
Basic earnings per share	$	0.42	$	0.33	$	1.11	$	0.95
Diluted earnings per share:								
Income from continuing operations, net of taxes	$	0.41	$	0.33	$	1.12	$	0.94
Income from discontinued operations, net of taxes						(0.01)		0.01

Diluted earnings per share	$ 0.41	$ 0.33	$ 1.10	$ 0.95
Weighted-average shares outstanding:				
Basic	31,708,581	31,621,049	31,683,288	31,583,897
Diluted	32,001,419	31,733,004	31,967,876	31,652,795

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net Income	$ 13,264	$ 10,385	$ 35,320	$ 29,930
Other comprehensive income, net of tax				
Unrealized gain (loss) on securities				
Unrealized holding (loss) gain arising during period	(4,947)	(10,020)	9,491	(16,141)
Less: reclassification adjustment for net gain included in net income	(67)	(611)	(1,852)	(923)
Unrealized (loss) gain on interest-only strip of servicing assets	(3)		(2)	1
Income tax benefit (expense) related to items of other comprehensive income	2,102	4,528	(3,322)	7,176
Other comprehensive (loss) income	(2,915)	(6,103)	4,315	(9,887)
Comprehensive Income	**$ 10,349**	**$ 4,282**	**$ 39,635**	**$ 20,043**

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity (Unaudited)

(In thousands, except share data)

	Common Stock - Number of Shares			Stockholders Equity					
	Shares Issued	Treasury Shares	Shares Outstanding	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Treasury Stock, at Cost	Total Stockholders Equity
Balance at January 1, 2013	**32,074,434**	**(577,894)**	**31,496,540**	**$ 257**	**$ 550,066**	**$ 5,418**	**$ (107,519)**	**$ (69,858)**	**$ 378,364**
Adjustment for the cumulative effect on prior years of retrospectively applying the new method of accounting							(1,112)		(1,112)
Exercises of stock options	40,678		40,678		139				139
Exercises of stock warrants	106,315		106,315		1,289				1,289
Restricted stock awards	110,582		110,582						
Share-based compensation expense					387				387
Comprehensive income:									
Net income							19,545		19,545
Change in unrealized gain on securities available for sale and interest-only strips, net of income taxes						(9,887)			(9,887)
	32,332,009	**(577,894)**	**31,754,115**	**$ 257**	**$ 551,881**	**$ (4,469)**	**$ (89,086)**	**$ (69,858)**	**$ 388,725**

Balance at September 30, 2013									
Balance at January 1, 2014	**32,339,444**	**(577,894)**	**31,761,550**	**$ 257**	**$ 552,270**	**$ (9,380)**	**$ (73,212)**	**$ (69,858)**	**$ 400,077**
Exercises of stock options	34,382		34,382		427				427
Exercises of stock warrants	429		429		2				2
Restricted stock awards	98,068		98,068						
Share-based compensation expense					1,747				1,747
Cash dividends							(6,694)		(6,694)
Comprehensive income:									
Net income							35,320		35,320
Change in unrealized loss on securities available for sale and interest-only strips, net of income taxes						4,315			4,315
Balance at September 30, 2014	**32,472,323**	**(577,894)**	**31,894,429**	**$ 257**	**$ 554,446**	**$ (5,065)**	**$ (44,586)**	**$ (69,858)**	**$ 435,194**

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2014	**2013**
Cash flows from operating activities:		
Net income	**$ 35,320**	**$ 29,930**
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	1,418	1,525
Amortization of premiums and accretion of discounts on investment securities, net	2,754	1,961
Amortization of other intangible assets	33	123
Amortization of servicing assets	1,318	1,152
Amortization of investment in affordable housing partnerships	592	552
Amortization of subordinated debentures	36	
Share-based compensation expense	1,747	387
Negative provision for credit losses	(7,166)	
Gain on sales of investment securities	(1,852)	(923)
Gain on sales of loans	(2,267)	(5,507)
Bargain purchase gain on acquisition	(6,593)	
Gain (loss) on sales of other real estate owned	2	(71)
Loss on sales of subsidiaries	419	
Valuation adjustment on other real estate owned		7
Origination of loans held for sale	(34,798)	(63,113)
Proceeds from sales of SBA loans guaranteed portion	29,826	77,338
Change in restricted cash		5,350
Change in accrued interest receivable	609	624
Change in FDIC loss sharing asset	1,996	
Change in bank-owned life insurance	(672)	(693)
Change in prepaid expenses	(1,338)	98
Change in other assets	(4,462)	767
Change in income tax assets	(3,066)	5,038
Change in accrued interest payable	(821)	(9,070)
Change in stock warrants payable		80
Change in other liabilities	11,670	2,422
Net cash provided by operating activities	**24,705**	**47,977**
Cash flows from investing activities:		
Proceeds from redemption of federal home loan bank and federal reserve bank stock		3,740
Proceeds from matured or called securities available for sale	61,145	62,104
Proceeds from sales of securities available for sale	135,834	41,560
Proceeds from sales of other real estate owned	9,932	1,645

Proceeds from sales of loans held for sale		5,380
Proceeds from insurance settlement on bank-owned life insurance		279
Cash acquired in acquisition, net of cash consideration paid	116,967	
Net proceeds from sales of subsidiaries	398	
Change in loans receivable	(157,988)	(131,169)
Purchases of securities available for sale	(124,442)	(53,762)
Purchases of premises and equipment	(739)	(567)
Purchases of federal reserve bank stock	(3,403)	(978)
Net cash provided by (used) in investing activities	**37,704**	**(71,768)**
Cash flows from financing activities:		
Change in deposits	(13,168)	33,744
Change in short-term federal home loan bank advances	(25,135)	
Redemption of Federal Home Loan Bank advances	(2,411)	(290)
Redemption of subordinated debentures		(82,406)
Proceeds from exercise of stock options	427	460
Proceeds from exercise of stock warrants		305
Cash dividends paid	(4,463)	(2,215)
Net cash used in financing activities	**(44,750)**	**(50,402)**
Net increase (decrease) in cash and cash equivalents	**17,659**	**(74,193)**
Cash and cash equivalents at beginning of year	179,357	268,047
Cash and cash equivalents at end of period	**$ 197,016**	**$ 193,854**
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 10,750	$ 19,239
Income taxes	$ 20,930	$ 11,910
Non-cash activities:		
Transfer of loans receivable to other real estate owned	$ 7,501	$ 1,090
Transfer of loans receivable to loans held for sale	$	$ 8,010
Transfer of loans held for sale to loans receivable	$	$ 2,534
Note receivable from sale of insurance subsidiaries	$ 1,394	$
Conversion of stock warrants into common stock	$ 2	$ 981
Income tax (expense) benefit related to items of other comprehensive income	$ (3,322)	$ 7,176
Change in unrealized (gain) loss in accumulated other comprehensive income	$ (9,489)	$ 16,140
Cash dividend declared	$ (2,231)	$

See Accompanying Notes to Consolidated Financial Statements (Unaudited)

Table of Contents

Hanmi Financial Corporation and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Three and Nine Months Ended September 30, 2014 and 2013

Note 1 Basis of Presentation

Hanmi Financial Corporation (Hanmi Financial, the Company, we or us) is a Delaware corporation and is subject to the Bank Holding Company Act of 1956, as amended. Hanmi Bank (the Bank), a California state chartered bank, is a wholly owned subsidiary of Hanmi Financial. During the second quarter of 2014, we disposed of two subsidiaries, Chun-Ha Insurance Services, Inc., a California corporation (Chun-Ha), and All World Insurance Services, Inc., a California corporation (All World). See Note 4 Sale of Insurance Subsidiaries and Discontinued Operations. On August 31, 2014, Hanmi Financial completed its acquisition of Central Bancorp, Inc. See Note 2 Acquisition.

In management s opinion, the accompanying unaudited consolidated financial statements of Hanmi Financial and its subsidiaries reflect all adjustments of a normal and recurring nature that are necessary for a fair presentation of the results for the interim period ended September 30, 2014, but are not necessarily indicative of the results that will be reported for the entire year or any other interim period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted. The aforementioned unaudited consolidated financial statements are in conformity with GAAP. Such interim consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission. The interim information should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (the 2013 Annual Report on Form 10-K).

The preparation of interim consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates subject to change include, among other items, the fair value estimates of assets acquired and liabilities assumed in Central Bancorp, Inc. (CBI) acquisition as discussed in Note 2 Acquisition. The acquired assets and assumed liabilities of Central Bancorp, Inc. were measured at their estimated fair values. The Company made significant estimates and exercised significant judgment in estimating fair values and accounting for such acquired assets and assumed liabilities.

Descriptions of our significant accounting policies are included in Note 1 Summary of Significant Accounting Policies in our 2013 Annual Report on Form 10-K. During the three months ended June 30, 2014, we adopted an accounting policy related to accounting for investments in low-income housing tax credit according to Financial Accounting Standards Board (FASB) ASU 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects.* See Note 3 Accounting for Investments in Qualified Affordable Housing Projects. During the three months ended September 30, 2014, we completed acquisition of CBI and our acquisition was accounted for using the acquisition method of accounting. See Note 2 Acquisition for more information about the CBI acquisition and Note 6 Loans for accounting policies regarding purchased loans.

Note 2 Acquisition

Acquisition of Central Bancorp, Inc.

On August 31, 2014, Hanmi Financial completed its acquisition of CBI, the parent company of United Central Bank (UCB). In the merger with CBI, each share of CBI common stock was exchanged for $17.64 per share or $50 million in the aggregate. In addition, Hanmi Financial paid $28.7 million to redeem CBI preferred stock and cumulative unpaid dividends and $1.6 million for accrued interest payable on CBI subordinated debentures immediately prior to the consummation of the merger. The merger consideration was funded from consolidated cash of Hanmi Financial. At August 31, 2014, CBI had total assets, liabilities and equity of $1.26 billion, $1.17 billion and $86.8 million, respectively. Total loans and deposits were $294.0 million and $1.1 billion, respectively, at August 31, 2014.

CBI was headquartered in Garland, Texas and through UCB, operated 23 branch locations within Texas, Illinois, Virginia, New York, New Jersey and California. The combined companies operate as Hanmi Financial Corporation and Hanmi Bank, respectively, with banking operations under the Hanmi Bank brand. Following the acquisition, Hanmi Bank has expanded its geographic presence through a network of 49 branches located throughout the United States. Key strategic benefits of the merger include 1) access to highly attractive markets with large Asian-American communities, creating business opportunities by leveraging Hanmi Bank s brand and business strategies, 2) ability to realize significant cost savings and operational efficiencies for the combined company, and 3) opportunity to prudently deploy capital at an attractive return for our shareholders.

Table of Contents

In connection with the acquisition, the consideration paid, the provisional estimate of the fair value of the assets acquired and the liabilities assumed as of August 31, 2014 are summarized in the following table:

	(In thousands)
Consideration paid:	
CBI Stockholders	$ 50,000
Redemption of preferred stock and cumulative unpaid dividends	28,675
Accrued interest on subordinated debentures	1,566
	80,241
Assets acquired:	
Cash and cash equivalents	197,209
Securities available for sale	663,497
Loans	294,032
Premises and equipment	17,735
Other real estate owned	28,027
Income tax assets, net	8,800
Core deposit intangible	2,213
FDIC loss sharing assets	9,692
Bank-owned life insurance	18,296
Other assets	16,428
Total assets acquired	1,255,929
Liabilities assumed:	
Deposits	1,098,997
Subordinated debentures	18,473
Rescinded stock obligation	15,720
FHLB advances	10,000
Other liabilities	25,905
Total liabilities assumed	1,169,095
Total identifiable net assets	**$ 86,834**
Bargain purchase gain, net of deferred taxes	**$ 6,593**

The CBI acquisition was accounted for under the acquisition method of accounting pursuant to ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of acquisition date. The Company made significant estimates and exercised significant judgment in estimating the fair values and accounting for such acquired assets and assumed liabilities. Such fair values are preliminary estimates and are subject to adjustment for up to one year after the acquisition date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier. The fair values are based on provisional valuation estimates of the fair values of the acquired assets and assumed liabilities. The valuation of acquired loans, income taxes and the core deposit intangibles are based on a preliminary estimate and are subject to change as the provisional amounts are finalized. The provisional application of the acquisition method of accounting resulted in a bargain purchase gain of $6.6 million. The operations of CBI are included in our operating results since the acquisition date for the third quarter of 2014. Acquisition-related costs of $3.6 million for the nine months ended September 30, 2014 are expensed as incurred as merger and integration costs. These expenses are comprised primarily of system conversion costs and professional fees.

The $294.0 million estimated fair value of loans acquired from CBI was determined by utilizing a discounted cash flow methodology considering credit and interest rate risk. Cash flows were determined by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value based on a current market rate for similar loans. There was no carryover of CBI s allowance for loan losses associated with the loans acquired as loans were initially recorded at fair value.

The following table summarizes the accretable yield on the purchased credit impaired loans acquired from the CBI merger at August 31, 2014.

	(In thousands)
Undiscounted contractual cash flows	$ 117,301
Nonaccretable discount	(18,565)
Undiscounted cash flow to be collected	98,736
Estimated fair value of PCI loans	75,878
Accretable yield	**$ 22,858**

The core deposit intangible (CDI) of $2.2 million was recognized for the core deposits acquired from CBI. The CDI is amortized over its useful life of approximately ten years on an accelerated basis and reviewed for impairment at least quarterly. The amortization expense for the third quarter of 2014 was $33,000.

The fair value of savings and transactional deposit accounts was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Expected cash flows were utilized for fair value calculation of the certificates of deposit based on the contractual terms of the certificates of deposit and the cash flows were discounted based on a current market rate for certificates of deposit with corresponding maturities. The premium for certificates of deposit was $11.3 million with $591,000 amortized in the third quarter of 2014.

The fair value of subordinated debentures was determined by estimating projected future cash flows and discounting them at a market rate of interest. A discount of $8.3 million was recognized for subordinated debentures, which will be amortized over their contractual term. The amortization for the third quarter of 2014 was $35,000.

Unaudited Pro Forma Results of Operations

The following table presents our unaudited pro forma results of operations for the periods presented as if the CBI acquisition had been completed on January 1, 2013. The unaudited pro forma results of operations include the historical accounts of Hanmi Financial and CBI and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The unaudited pro forma information is intended for informational purposes only and is not necessarily indicative of our future operating results or operating results that would have occurred had the CBI acquisition been completed at the beginning of 2013. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
	(In thousands, except per share data)			
Pro forma revenues (net interest income plus noninterest income)	$ 62,427	$ 55,727	$ 170,923	$ 182,135
Pro forma net income from continuing operations	$ 18,359	$ 12,826	$ 43,546	$ 47,201
Pro forma earnings per share from continuing operations:				
Basic	$ 0.58	$ 0.41	$ 1.37	$ 1.49
Diluted	$ 0.57	$ 0.40	$ 1.36	$ 1.49

Note 3 Accounting for Investments in Qualified Affordable Housing Projects

The Bank invests in qualified affordable housing projects (low income housing) and previously accounted for them under the equity method of accounting. The Bank recognized its share of partnership losses in other operating expenses with the tax benefits recognized in the income tax provision. In January 2014, the FASB issued ASU 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*, which amends ASC 323 to provide the ability to elect the proportional amortization method with the amortization expense and tax benefits recognized through the income tax provision. This ASU is effective for the annual period beginning after December 15, 2014, with early adoption being permitted. The Bank elected to early adopt the provisions of the ASU in the second quarter of 2014 and elected the proportional amortization method as retrospective transition. This accounting change in the amortization methodology resulted in changes to account for amortization recognized in prior periods, which impacted the balance of tax credit investments and related tax accounts. The investment amortization expense is presented as a component of the income tax provision.

The cumulative effect of the retrospective application of this accounting principle as of January 1, 2012 was a negative $1.1 million. Net income in the three and nine months ended September 30, 2013 increased by $135,000 and $51,000, respectively, due to the change in accounting principle.

Table of Contents

The following tables present the effect of the retrospective application of this change in accounting principle on the Company s Consolidated Balance Sheets, Statements of Income and Statement of Cash Flows for the respective periods:

Hanmi Financial Corporations and Subsidiaries

Consolidated Balance Sheet (Unaudited)

	As of December 31, 2013		
	As Previously Reported	**Effect of Change in Accounting Principle**	**As Adjusted**
		(In thousands)	
Assets			
Cash and cash equivalents	$ 179,357	$	$ 179,357
Securities available for sale	530,926		530,926
Loans receivable	2,177,498		2,177,498
Income tax assets	63,536	305	63,841
Other assets	104,222	(1,465)	102,757
Total assets	**$ 3,055,539**	**$ (1,160)**	**$ 3,054,379**
Liabilities and stockholders equity			
Liabilities	$ 2,654,302	$	$ 2,654,302
Stockholders equity	401,237	(1,160)	400,077
Total liabilities and stockholders equity	**$ 3,055,539**	**$ (1,160)**	**$ 3,054,379**

11

Table of Contents

Hanmi Financial Corporations and Subsidiaries

Consolidated Statements of Income (Unaudited)

	For the Three Months Ended September 30, 2013		
	As Previously Reported	**Effect of Change in Accounting Principle**	**As Adjusted**
	(In thousands, except per share data)		
Interest and dividend income	$ 31,627	$	$ 31,627
Interest expense	3,153		3,153
Net interest income	$ 28,474	$	$ 28,474
Noninterest income	6,059		6,059
Noninterest expense	17,811	(175)	17,636
Income before provision for income taxes	$ 16,722	$ 175	$ 16,897
Provision for income taxes	6,542	40	6,582
Income from continuing operations	**$ 10,180**	**$ 135**	**$ 10,315**
Earnings per share from continuing operations			
Basic	$ 0.32	$ 0.01	$ 0.33
Diluted	$ 0.32	$ 0.01	$ 0.33

	For the Nine Months Ended September 30, 2013		
	As Previously Reported	**Effect of Change in Accounting Principle**	**As Adjusted**
	(In thousands, except per share data)		
Interest and dividend income	$ 91,401	$	$ 91,401
Interest expense	10,169		10,169
Net interest income	$ 81,232	$	$ 81,232
Noninterest income	19,945		19,945
Noninterest expense	54,451	(553)	53,898
Income before provision for income taxes	$ 46,726	$ 553	$ 47,279
Provision for income taxes	17,008	502	17,510
Income from continuing operations	**$ 29,718**	**$ 51**	**$ 29,769**

Earnings per share from continuing operations			
Basic	$ 0.94	$	$ 0.94
Diluted	$ 0.94	$	$ 0.94

Hanmi Financial Corporations and Subsidiaries

Consolidated Statement of Cash Flows (Unaudited)

	For the Nine Months Ended September 30, 2013		
	As Previously Reported	**Effect of Change in Accounting Principle**	**As Adjusted**
		(In thousands)	
Cash flows from operating activities:			
Net income	$ 29,879	$ 51	$ 29,930
Total adjustment in net income	18,098	(51)	18,047
Net cash provided by operating activities	$ 47,977	$	$ 47,977
Cash flows from investing activities:			
Net cash used in investing activities	(71,768)		(71,768)
Cash flows from financing activities:			
Net cash used in financing activities	(50,402)		(50,402)
Net decrease in cash and cash equivalents	$ (74,193)	$	$ (74,193)
Cash and cash equivalents at beginning of period	268,047		268,047
Cash and cash equivalents at end of period	**$ 193,854**	$	**$ 193,854**

12

Table of Contents

The Bank determined that there were no events or changes in circumstances indicating that it is more likely than not that the carrying amount of the investment will not be realized. Therefore, no impairment was recognized as of September 30, 2014 or December 31, 2013. The investment in low income housing was $21.8 million and $3.0 million as of September 30, 2014 and December 31, 2013, respectively. The Bank s unfunded commitments related to low income housing investments was $12.6 million as of September 30, 2014 and there were none as of December 31, 2013. The Bank recognized $592,000 and $1.0 million as a component of income tax expense during the three and nine months ended September 30, 2014, respectively, and tax credits and other benefits received from the tax expenses were $821,000 and $1.4 million during the three and nine months ended September 30, 2014, respectively.

Note 4 Sale of Insurance Subsidiaries and Discontinued Operations

In June 2014, Hanmi Financial sold its insurance subsidiaries, Chun-Ha and All World, and entered into a stock purchase agreement for their sale. The subsidiaries were classified as held for sale in April 2014 and accounted for as discontinued operations. The operations and cash flows of the businesses have been eliminated and in accordance with the provisions of ASC 205, *Presentation of Financial Statements*, the results are reported as discontinued operations for all periods presented.

Hanmi Financial completed the sale of its two insurance subsidiaries to Chunha Holding Corporation on June 30, 2014. The total sales price was $3.5 million, of which $2.0 million was paid upon signing. The $2.0 million was reduced by $1.6 million cash and cash equivalents included in net assets of Chun-Ha and All World, resulting in $398,000 net cash proceeds. The remaining $1.5 million will be payable in three equal installments on each anniversary of the closing date through June 30, 2017.

The sale resulted in a $51,000 gain and a $4,000 income tax benefit from operating loss, offset by a $470,000 capital gain tax and a $52,000 operating loss. Consequently, net loss from discontinued operations in the second quarter of 2014 was $467,000, or $0.01 per diluted share. The discontinued operations generated noninterest income, primarily in the line item for insurance commissions, of $2.7 million in the first six months of 2014 and $1.3 million in the first quarter of 2014. They also incurred noninterest expense of $2.7 million in various line items in the first six months of 2014 and $1.4 million in the first quarter of 2014.

Summarized financial information for our discontinued operations related to Chun-Ha and All World are as follows:

	June 30, 2014	December 31, 2013
	(In thousands)	
Cash and cash equivalents	$ 1,602	$ 1,396
Premises and equipment, net	90	79
Other intangible assets, net	1,089	1,171
Other assets	2,855	3,298
Total assets	**$ 5,636**	**$ 5,944**
Income tax payable	$ 415	$ 1,304
Accrued expenses and other liabilities	1,878	2,171

Total liabilities	**$ 2,293**	**$ 3,475**
Net assets of discontinued operations	**$ 3,343**	**$ 2,469**

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	2013
		(In thousands)	
Noninterest income (loss)	$ 112	$ (14)	$ 242
Gain on disposal		51	
Income before taxes	$ 112	$ 37	$ 242
Provision for income taxes	42	481	81
Net income (loss) from discontinued operations	**$ 70**	**$ (444)**	**$ 161**

13

Table of Contents

Note 5 Investment Securities

The following is a summary of investment securities available for sale as of September 30, 2014 and December 31, 2013:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
		(In thousands)		
September 30, 2014				
Mortgage-backed securities [1] [2]	$ 588,638	$ 230	$ 4,711	$ 584,157
Collateralized mortgage obligations [1]	197,784	146	1,719	196,211
U.S. government agency securities	176,449		3,656	172,793
SBA loan pool securities	114,753	64	700	114,117
Municipal bonds-tax exempt	4,335	94		4,429
Municipal bonds-taxable	16,666	141	147	16,660
Corporate bonds	17,018	11	89	16,940
U.S. treasury securities	164		1	163
Other securities	22,916		212	22,704
Equity security	450			450
Total securities available for sale	**$ 1,139,173**	**$ 686**	**$ 11,235**	**$ 1,128,624**
December 31, 2013				
Mortgage-backed securities [1]	$ 222,768	$ 317	$ 6,026	$ 217,059
Collateralized mortgage obligations [1]	130,636	274	3,217	127,693
U.S. government agency securities	90,852		7,316	83,536
Municipal bonds-tax exempt	13,857	110	30	13,937
Municipal bonds-taxable	33,361	73	1,080	32,354
Corporate bonds	21,013	8	186	20,835
U.S. treasury securities	19,998		1	19,997
SBA loan pool securities	13,598		969	12,629
Other securities	3,030		144	2,886
Total securities available for sale	**$ 549,113**	**$ 782**	**$ 18,969**	**$ 530,926**

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

(2) *A portion of the mortgage-backed securities is comprised of home mortgage-backed securities backed by home equity conversion mortgages*

The amortized cost and estimated fair value of investment securities as of September 30, 2014, by contractual maturity, are shown below. Although mortgage-backed securities and collateralized mortgage obligations have contractual maturities through 2064, expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
	Amortized Cost	Estimated Fair Value
	(In thousands)	
Within one year	$ 15,702	$ 15,721
Over one year through five years	73,633	73,247
Over five years through ten years	139,745	136,900
Over ten years	100,305	99,234
Mortgage-backed securities	588,638	584,157
Collateralized mortgage obligations	197,784	196,211
Other securities	22,916	22,704
Equity security	450	450
Total	**$ 1,139,173**	**$ 1,128,624**

Table of Contents

FASB ASC 320, *Investments Debt and Equity Securities*, requires us to periodically evaluate our investments for other-than-temporary impairment (OTTI). There was no OTTI charge during the nine months ended September 30, 2014.

Gross unrealized losses on investment securities available for sale, the estimated fair value of the related securities and the number of 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 September 30, 2014 and December 31, 2013:

	Holding Period								
	Less Than 12 Months			12 Months or More			Total		
	Gross Unrealized Loss	Estimated Fair Value	Number of Securities	Gross Unrealized Loss	Estimated Fair Value	Number of Securities	Gross Unrealized Loss	Estimated Fair Value	Number of Securities
	(In thousands, except number of securities)								
September 30, 2014									
Mortgage-backed securities	$ 2,947	$ 422,318	73	$ 1,764	$ 60,057	22	$ 4,711	$ 482,375	95
Collateralized mortgage obligations	914	145,816	30	805	21,188	9	1,719	167,004	39
U.S. government agency securities	537	85,948	22	3,119	71,843	26	3,656	157,791	48
SBA loan pool securities	27	87,088	15	673	12,037	4	700	99,125	19
Municipal bonds-taxable	9	2,238	2	138	5,511	5	147	7,749	7
Corporate bonds				89	7,902	2	89	7,902	2
U.S. treasury securities	1	163	1				1	163	1
Other securities	111	19,775	1	101	2,924	5	212	22,699	6
Total	**$ 4,546**	**$ 763,346**	**144**	**$ 6,689**	**$ 181,462**	**73**	**$ 11,235**	**$ 944,808**	**217**
December 31, 2013									
Mortgage-backed securities	$ 3,437	$ 170,324	51	$ 2,589	$ 30,947	12	$ 6,026	$ 201,271	63
Collateralized mortgage obligations	2,353	87,026	27	864	14,657	7	3,217	101,683	34
U.S. government agency securities	3,942	50,932	19	3,374	32,606	12	7,316	83,538	31
Municipal bonds-tax exempt	30	8,562	5				30	8,562	5
Municipal bonds-taxable	787	22,817	16	293	3,813	4	1,080	26,630	20
Corporate bonds	9	5,024	1	177	11,803	3	186	16,827	4
U.S. treasury bills	1	19,996	2				1	19,996	2
SBA loan pool securities				969	12,629	4	969	12,629	4
Other securities	48	1,957	3	96	929	3	144	2,886	6
Total	**$ 10,607**	**$ 366,638**	**124**	**$ 8,362**	**$ 107,384**	**45**	**$ 18,969**	**$ 474,022**	**169**

All individual securities that have been in a continuous unrealized loss position for 12 months or longer as of September 30, 2014 and December 31, 2013 had investment grade ratings upon purchase. The issuers of these securities have not established any cause for default on these securities and the various rating agencies have reaffirmed these securities long-term investment grade status as of September 30, 2014 and December 31, 2013. These securities have fluctuated in value since their purchase dates as market interest rates have fluctuated.

FASB ASC 320 requires other-than-temporarily impaired investment securities to be written down when fair value is below amortized cost in circumstances where: (1) an entity has the intent to sell a security; (2) it is more likely than not that an entity will be required to sell the security before recovery of its amortized cost basis; or (3) an entity does not expect to recover the entire amortized cost basis of the security. If an entity intends to sell a security or if it is more likely than not the entity will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security s amortized cost basis and its fair value. If an entity does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income.

The Company does not intend to sell these securities and it is more likely than not that we will not be required to sell the investments before the recovery of its amortized cost basis. In addition, the unrealized losses on municipal and corporate bonds are not considered other-than-temporarily impaired, as the bonds are rated investment grade and there are no credit quality concerns with the issuers. Interest payments have been made as scheduled, and management believes this will continue in the future and that the bonds will be repaid in full as scheduled. 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 September 30, 2014 and December 31, 2013 were not other-than-temporarily impaired, and therefore, no impairment charges as of September 30, 2014 and December 31, 2013 were warranted.

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
	(In thousands)			
Gross realized gains on sales of investment securities	$ 67	$ 619	$ 1,853	$ 932
Gross realized losses on sales of investment securities		(8)	(1)	(9)
Net realized gains on sales of investment securities	**$ 67**	**$ 611**	**$ 1,852**	**$ 923**
Proceeds from sales of investment securities	$ 9,778	$ 26,661	$ 140,855	$ 51,425

For the three months ended September 30, 2014, there was a $67,000 gain in earnings resulting from the sale of investment securities that had previously been recorded as net unrealized gains of $23,000 in comprehensive income. For the three months ended September 30, 2013, there was a $611,000 net gain in earnings resulting from the sale of investment securities that had previously been recorded as net unrealized gains of $899,000 in comprehensive income.

For the nine months ended September 30, 2014, there was a $1.9 million net gain in earnings resulting from the redemption and sale of investment securities that had previously been recorded as net unrealized losses of $498,000 in comprehensive income. For the nine months ended September 30, 2013, there was a $923,000 net gain in earnings resulting from the redemption and sale of investment securities that had previously been recorded as net unrealized gains of $2.4 million in comprehensive income.

Investment securities available for sale with par values of $79.9 million and $47.6 million as of September 30, 2014 and December 31, 2013, respectively, were pledged to secure Federal Home Loan Bank (FHLB) advances, public deposits and for other purposes as required or permitted by law.

Table of Contents

Note 6 Loans

The loan portfolio includes originated and purchased loans. Originated loans and purchased loans for which there was no evidence of credit deterioration at their acquisition date and it was probable that we would be able to collect all contractually required payments, are referred to collectively as non-purchased credit impaired loans, or Non-PCI loans. Purchased loans for which there was, at the acquisition date, evidence of credit deterioration since their origination and it was probable that we would be unable to collect all contractually required payments are referred to as purchased credit impaired loans, or PCI loans .

Non-PCI loans are carried at the principal amount outstanding, net of deferred fees and costs, and in the case of acquired loans, net of purchase discounts and premiums. Deferred fees and costs and purchase discounts and premiums on acquired non-impaired loans are recognized as an adjustment to interest income over the contractual life of the loans using the effective interest method or taken into income when the related loans are paid off or sold.

PCI loans are accounted for in accordance with ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. For PCI loans, at the time of acquisition, we (i) calculate the contractual amount and timing of undiscounted principal and interest payments (the undiscounted contractual cash flows) and (ii) estimate the amount and timing of undiscounted expected principal and interest payments (the undiscounted expected cash flows). The difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The difference between the undiscounted cash flows expected to be collected and the estimated fair value of the acquired loans is the accretable yield. The accretable yield is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. PCI loans may be placed on nonaccrual status, including use of the cost recovery method or cash basis method of income recognition, if information is not available to reasonably estimate cash flows expected to be collected to compute its yield. The nonaccretable difference represents an estimate of the loss exposure of principal and interest related to PCI loans; such amount is subject to change over time based on the performance of such loans. The carrying value of PCI loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income.

As part of the fair value process and the subsequent accounting, the Company aggregates PCI loans into pools having common credit risk characteristics such as type and risk rating. Increases in expected cash flows over those previously estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in the amount and changes in the timing of expected cash flows compared to those previously estimated decrease the accretable yield and usually result in a provision for loan losses and the establishment of an allowance for loan losses. As the accretable yield increases or decreases from changes in cash flow expectations, the offset is a decrease or increase to the nonaccretable difference. The accretable yield is measured at each financial reporting date based on information then currently available and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans.

PCI loans that are contractually past due are still considered to be accruing and performing as long as there is an expectation that the estimated cash flows will be received. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual with interest income recognized on either a cash basis or as a reduction of the principal amount outstanding.

The Board of Directors and management review and approve the Bank s loan policy and procedures on a regular basis to reflect issues such as regulatory and organizational structure changes, strategic planning revisions, concentrations of credit, loan delinquencies and nonperforming loans, problem loans, and policy adjustments.

Real estate loans are loans secured by liens or interest in real estate, to provide purchase, construction, and refinance on real estate properties. Commercial and industrial loans consist of commercial term loans, commercial lines of credit, and Small Business Administration (SBA) loans. Consumer loans consist of auto loans, credit cards, personal loans, and home equity lines of credit. We maintain management loan review and monitoring functions that review and monitor pass graded loans as well as problem loans to prevent further deterioration.

The majority of the Bank s loan portfolio consists of commercial real estate and commercial and industrial loans. The Bank has been diversifying and monitoring commercial real estate loans based on property types, underwriting standards, and portfolio liquidity and management, and certain specified limits set forth in the Bank s loan policy. To date, most of the Bank s lending activity occurred within Southern California. With the acquisition of CBI, our lending activities in other areas of the country will increase.

Table of Contents

Loans Receivable

Loans receivable consisted of the following as of the dates indicated:

	September 30, 2014			December 31, 2013
	Non-PCI Loans	PCI Loans	Total	
		(In thousands)		
Real estate loans:				
Commercial property [1]				
Retail	$ 635,861	$ 15,940	$ 651,801	$ 543,619
Hotel/Motel	452,405	14,206	466,611	322,927
Gas station	340,386	18,069	358,455	292,557
Other	805,696	15,715	821,411	731,617
Construction	4,146		4,146	
Residential property	106,044	2,686	108,730	79,078
Total real estate loans	2,344,538	66,616	2,411,154	1,969,798
Commercial and industrial loans:				
Commercial term	119,175	350	119,525	124,391
Commercial lines of credit	75,246		75,246	71,042
International loans	41,127		41,127	36,353
Total commercial and industrial loans	235,548	350	235,898	231,786
Consumer loans	28,849	58	28,907	32,505
Total gross loans	**2,608,935**	**67,024**	**2,675,959**	**2,234,089**
Allowance for loans losses	(51,179)		(51,179)	(57,555)
Deferred loan costs	3,311		3,311	964
Loans receivable, net	**$ 2,561,067**	**$ 67,024**	**$ 2,628,091**	**$ 2,177,498**

(1) *Includes owner-occupied property loans of $1.10 billion and $957.3 million as of September 30, 2014 and December 31, 2013, respectively.*

Accrued interest on loans receivable was $5.8 million and $5.4 million at September 30, 2014 and December 31, 2013, respectively. At September 30, 2014 and December 31, 2013, loans receivable totaling $872.2 million and $568.7 million, respectively, were pledged to secure advances from the FHLB and the Federal Reserve Bank s (FRB) federal discount window.

The following table details the information on the sales and reclassifications of loans receivable to loans held for sale (excluding PCI loans) by portfolio segment for the three months ended September 30, 2014 and 2013:

	Real Estate	Commercial and Industrial	Consumer	Total Non-PCI
		(In thousands)		
September 30, 2014				
Balance at beginning of period	$ 2,568	$ 1,274	$	$ 3,842
Origination of loans held for sale	15,198	3,031		18,229
Sales of loans held for sale	(12,135)	(2,133)		(14,268)
Principal payoffs and amortization	(20)	(26)		(46)
Balance at end of period	**$ 5,611**	**$ 2,146**	**$**	**$ 7,757**
September 30, 2013				
Balance at beginning of period	$ 2,137	$ 416	$	$ 2,553
Origination of loans held for sale	15,634	1,501		17,135
Reclassification from loans held for sale to loans receivable	(2,118)	(416)		(2,534)
Sales of loans held for sale	(10,725)	(1,181)		(11,906)
Principal payoffs and amortization	(20)			(20)
Balance at end of period	**$ 4,908**	**$ 320**	**$**	**$ 5,228**

Table of Contents

For the three months ended September 30, 2014, there was no reclassification of Non-PCI loans receivable as Non-PCI loans held for sale, and Non-PCI loans held for sale of $14.3 million were sold. In addition, there was no reclassification from Non-PCI loans held for sale to Non-PCI loans receivable. For the three months ended September 30, 2013, there was no reclassification of Non-PCI loans receivable as Non-PCI loans held for sale, and Non-PCI loans held for sale of $11.9 million were sold.

The following table details the information on the sales and reclassifications of loans receivable to loans held for sale (excluding PCI loans) by portfolio segment for the nine months ended September 30, 2014 and 2013:

	Real Estate	Commercial and Industrial	Consumer	Total Non-PCI
		(In thousands)		
September 30, 2014				
Balance at beginning of period	$	$	$	$
Origination of loans held for sale	29,591	5,207		34,798
Sales of loans held for sale	(23,953)	(3,033)		(26,986)
Principal payoffs and amortization	(27)	(28)		(55)
Balance at end of period	**$ 5,611**	**$ 2,146**	**$**	**$ 7,757**
September 30, 2013				
Balance at beginning of period	$ 7,977	$ 329	$	$ 8,306
Origination of loans held for sale	58,725	4,387		63,112
Reclassification from loans receivable to loans held for sale	7,593	416		8,009
Reclassification from loans held for sale to loans receivable	(2,118)	(416)		(2,534)
Sales of loans held for sale	(67,235)	(4,391)		(71,626)
Principal payoffs and amortization	(34)	(5)		(39)
Balance at end of period	**$ 4,908**	**$ 320**	**$**	**$ 5,228**

For the nine months ended September 30, 2014, there was no reclassification of Non-PCI loans receivable as Non-PCI loans held for sale, and Non-PCI loans held for sale of $27.0 million were sold. In addition, there was no reclassification from Non-PCI loans held for sale to Non-PCI loans receivable. For the nine months ended September 30, 2013, Non-PCI loans receivable of $8.0 million were reclassified as Non-PCI loans held for sale, and Non-PCI loans held for sale of $71.6 million were sold.

Allowance for Loan Losses and Allowance for Off-Balance Sheet Items

Activity in the allowance for loan losses and allowance for off-balance sheet items was as follows for the periods indicated:

	As of and for the Three Months Ended		As of and for the Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(In thousands)			
Allowance for loan losses:				
Balance at beginning of period	$ 51,886	$ 59,876	$ 57,555	$ 63,305
Charge-offs	(1,418)	(4,610)	(5,569)	(11,124)
Recoveries on loans previously charged off	663	2,383	6,656	4,964
Net loan (charge-offs) recoveries	(755)	(2,227)	1,087	(6,160)
Provision (negative provision) charged to operating expense	48	(10)	(7,463)	494
Balance at end of period	**$ 51,179**	**$ 57,639**	**$ 51,179**	**$ 57,639**
Allowance for off-balance sheet items:				
Balance at beginning of period	$ 1,592	$ 1,320	$ 1,247	$ 1,824
(Negative provision) provision charged to operating expense	(48)	10	297	(494)
Balance at end of period	**$ 1,544**	**$ 1,330**	**$ 1,544**	**$ 1,330**

19

Table of Contents

There was no allowance for loan losses on our PCI loans as of September 30, 2014. The allowance for off-balance sheet items is maintained at a level believed to be sufficient to absorb estimated probable losses related to these unfunded credit facilities. The determination of the allowance adequacy is based on periodic evaluations of the unfunded credit facilities including an assessment of the probability of commitment usage, credit risk factors for loans outstanding to these same customers, and the terms and expiration dates of the unfunded credit facilities. As of September 30, 2014 and 2013, the allowance for off-balance sheet items amounted to $1.5 million and $1.3 million, respectively. Net adjustments to the allowance for off-balance sheet items are included in the provision for credit losses.

The following table details the information on the allowance for loan losses by portfolio segment for the three months ended September 30, 2014 and 2013:

	Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
			(In thousands)		
September 30, 2014					
Allowance for loan losses:					
Beginning balance	$ 40,303	$ 9,738	$ 540	$ 1,305	$ 51,886
Charge-offs	(884)	(499)	(35)		(1,418)
Recoveries on loans previously charged off	293	365	5		663
(Negative provision) provision	179	260	(186)	(205)	48
Ending balance	**$ 39,891**	**$ 9,864**	**$ 324**	**$ 1,100**	**$ 51,179**
Ending balance: individually evaluated for impairment	$ 2,027	$ 3,757	$	$	$ 5,784
Ending balance: collectively evaluated for impairment	$ 37,864	$ 6,107	$ 324	$ 1,100	$ 45,395
Loans receivable:					
Ending balance	**$ 2,411,154**	**$ 235,898**	**$ 28,907**	**$**	**$ 2,675,959**
Ending balance: individually evaluated for impairment	$ 35,654	$ 11,970	$ 1,758	$	$ 49,382
Ending balance: collectively evaluated for impairment	$ 2,308,884	$ 223,578	$ 27,091	$	$ 2,559,553
Ending balance: acquired with deteriorated credit quality	$ 66,616	$ 350	$ 58	$	$ 67,024

Consumer	Unallocated	Total

	Real Estate	Commercial and Industrial			
			(In thousands)		
September 30, 2013					
Allowance for loan losses:					
Beginning balance	$ 46,396	$ 11,118	$ 1,884	$ 478	$ 59,876
Charge-offs	(1,017)	(3,575)	(18)		(4,610)
Recoveries on loans previously charged off	1,641	737	5		2,383
Provision (negative provision)	(1,795)	388	(232)	1,629	(10)
Ending balance	**$ 45,225**	**$ 8,668**	**$ 1,639**	**$ 2,107**	**$ 57,639**
Ending balance: individually evaluated for impairment	$ 564	$ 1,475	$ 330	$	$ 2,369
Ending balance: collectively evaluated for impairment	$ 44,661	$ 7,193	$ 1,309	$ 2,107	$ 55,270
Loans receivable:					
Ending balance	**$ 1,921,659**	**$ 203,547**	**$ 34,065**	**$**	**$ 2,159,271**
Ending balance: individually evaluated for impairment	$ 29,424	$ 12,468	$ 1,574	$	$ 43,466
Ending balance: collectively evaluated for impairment	$ 1,892,235	$ 191,079	$ 32,491	$	$ 2,115,805

Table of Contents

The following table details the information on the allowance for loan losses by portfolio segment for the nine months ended September 30, 2014 and 2013:

	Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
			(In thousands)		
September 30, 2014					
Allowance for loan losses:					
Beginning balance	$ 43,550	$ 11,287	$ 1,427	$ 1,291	$ 57,555
Charge-offs	(2,073)	(3,394)	(102)		(5,569)
Recoveries on loans previously charged off	3,298	3,338	20		6,656
(Negative provision) provision	(4,884)	(1,367)	(1,021)	(191)	(7,463)
Ending balance	**$ 39,891**	**$ 9,864**	**$ 324**	**$ 1,100**	**$ 51,179**
Ending balance: individually evaluated for impairment	$ 2,027	$ 3,757	$	$	$ 5,784
Ending balance: collectively evaluated for impairment	$ 37,864	$ 6,107	$ 324	$ 1,100	$ 45,395
Loans receivable:					
Ending balance	**$ 2,411,154**	**$ 235,898**	**$ 28,907**	**$**	**$ 2,675,959**
Ending balance: individually evaluated for impairment	$ 35,654	$ 11,970	$ 1,758	$	$ 49,382
Ending balance: collectively evaluated for impairment	$ 2,308,884	$ 223,578	$ 27,091	$	$ 2,559,553
Ending balance: acquired with deteriorated credit quality	$ 66,616	$ 350	$ 58	$	$ 67,024

	Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
			(In thousands)		
September 30, 2013					
Allowance for loan losses:					
Beginning balance	$ 49,472	$ 10,636	$ 2,280	$ 917	$ 63,305
Charge-offs	(4,592)	(6,314)	(218)		(11,124)
Recoveries on loans previously charged off	2,923	1,981	60		4,964
Provision (negative provision)	(2,578)	2,365	(483)	1,190	494

Ending balance	**$**	**45,225**	**$**	**8,668**	**$**	**1,639**	**$**	**2,107**	**$**	**57,639**
Ending balance: individually evaluated for impairment	$	564	$	1,475	$	330	$		$	2,369
Ending balance: collectively evaluated for impairment	$	44,661	$	7,193	$	1,309	$	2,107	$	55,270
Loans receivable:										
Ending balance	**$**	**1,921,659**	**$**	**203,547**	**$**	**34,065**	**$**		**$**	**2,159,271**
Ending balance: individually evaluated for impairment	$	29,424	$	12,468	$	1,574	$		$	43,466
Ending balance: collectively evaluated for impairment	$	1,892,235	$	191,079	$	32,491	$		$	2,115,805

Credit Quality Indicators

As part of the on-going monitoring of the credit quality of our loan portfolio, we utilize an internal loan grading system to identify credit risk and assign an appropriate grade (from (0) to (8)) for each and every loan in our loan portfolio. A third party loan review is required on an annual basis. Additional adjustments are made when determined to be necessary. The loan grade definitions are as follows:

Pass and Pass-Watch: Pass and Pass-Watch loans, grades (0-4), are in compliance in all respects with the Bank s credit policy and regulatory requirements, and do not exhibit any potential or defined weaknesses as defined under Special Mention, Substandard or Doubtful. This category is the strongest level of the Bank s loan grading system. It incorporates all performing loans with no credit weaknesses. It includes cash and stock/security secured loans or other investment grade loans.

Special Mention: A Special Mention credit, grade (5), has potential weaknesses that deserve management s close attention. If not corrected, these potential weaknesses may result in deterioration of the repayment of the debt and result in a Substandard classification. Loans that have significant actual, not potential, weaknesses are considered more severely classified.

Substandard: A Substandard credit, grade (6), has a well-defined weakness that jeopardizes the liquidation of the debt. A credit graded Substandard is not protected by the sound worth and paying capacity of the borrower, or of the value and type of collateral pledged. With a Substandard loan, there is a distinct possibility that the Bank will sustain some loss if the weaknesses or deficiencies are not corrected.

21

Table of Contents

Doubtful: A Doubtful credit, grade (7), is one that has critical weaknesses that would make the collection or liquidation of the full amount due improbable. However, there may be pending events which may work to strengthen the credit, and therefore the amount or timing of a possible loss cannot be determined at the current time.

Loss: A loan classified as Loss, grade (8), is considered uncollectible and of such little value that their continuance as active bank assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this asset even though partial recovery may be possible in the future. Loans classified as Loss will be charged off in a timely manner.

As of September 30, 2014 and December 31, 2013, pass/pass-watch (grade 0-4), criticized (grade 5) and classified (grade 6-7) loans (excluding PCI loans), disaggregated by loan class, were as follows:

	As of September 30, 2014			
	Pass/Pass-Watch (Grade 0-4)	**Criticized (Grade 5)**	**Classified (Grade 6-7)**	**Total**
	(In thousands)			
Real estate loans:				
Commercial property				
Retail	$ 620,511	$ 12,821	$ 2,529	$ 635,861
Hotel/Motel	399,006	48,995	4,404	452,405
Gas station	320,501	10,054	9,831	340,386
Other	780,400	13,599	11,697	805,696
Construction	4,146			4,146
Residential property	103,812	122	2,110	106,044
Commercial and industrial loans:				
Commercial term	108,908	1,315	8,952	119,175
Commercial lines of credit	74,286		960	75,246
International loans	38,676		2,451	41,127
Consumer loans	26,626	140	2,083	28,849
Total Non-PCI loans	**$ 2,476,872**	**$ 87,046**	**$ 45,017**	**$ 2,608,935**

	As of December 31, 2013			
	Pass/Pass-Watch (Grade 0-4)	**Criticized (Grade 5)**	**Classified (Grade 6-7)**	**Total**
	(In thousands)			
Real estate loans:				
Commercial property				
Retail	$ 531,014	$ 5,309	$ 7,296	$ 543,619
Hotel/Motel	308,483	1,796	12,648	322,927
Gas station	279,636	3,104	9,817	292,557
Other	690,481	8,524	32,612	731,617

Residential property	77,422		1,656	79,078
Commercial and industrial loans:				
Commercial term	107,712	2,007	14,672	124,391
Commercial lines of credit	69,823		1,219	71,042
International loans	35,777	576		36,353
Consumer loans	30,044	163	2,298	32,505
Total Non-PCI loans	**$ 2,130,392**	**$ 21,479**	**$ 82,218**	**$ 2,234,089**

The following is an aging analysis of past due loans (excluding PCI loans), disaggregated by loan class, as of the dates indicated:

	As of September 30, 2014						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	Accruing 90 Days or More Past Due
	(In thousands)						
Real estate loans:							
Commercial property							
Retail	$ 1,927	$ 146	$ 182	$ 2,255	$ 633,606	$ 635,861	$
Hotel/Motel	52	733	1,203	1,988	450,417	452,405	
Gas station	4,781	794	544	6,119	334,267	340,386	
Other	1,867	67	380	2,314	803,382	805,696	15
Construction					4,146	4,146	
Residential property	113	121	486	720	105,324	106,044	
Commercial and industrial loans:							
Commercial term	1,410	587	2,873	4,870	114,305	119,175	
Commercial lines of credit	274	197		471	74,775	75,246	
International loans	251			251	40,876	41,127	
Consumer loans			248	248	28,601	28,849	
Total Non-PCI loans	**$ 10,675**	**$ 2,645**	**$ 5,916**	**$ 19,236**	**$ 2,589,699**	**$ 2,608,935**	**$ 15**

	As of December 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total	Accruing 90 Days or More Past Due
	(In thousands)						
Real estate loans:							
Commercial property							
Retail	$ 202	$ 426	$ 2,196	$ 2,824	$ 540,794	$ 543,618	$
Hotel/Motel	1,087		1,532	2,619	320,308	322,927	
Gas station	141	410	153	704	291,853	292,557	
Other	423	2,036	839	3,298	728,320	731,618	
Residential property		122	279	401	78,677	79,078	
Commercial and industrial loans:							
Commercial term	1,443	886	3,269	5,598	118,793	124,391	
Commercial lines of credit		150	250	400	70,642	71,042	
International loans					36,353	36,353	

Consumer loans	311	42	77	430	32,075	32,505	
Total Non-PCI loans	**$ 3,607**	**$ 4,072**	**$ 8,595**	**$ 16,274**	**$ 2,217,815**	**$ 2,234,089**	**$**

Impaired Loans

Loans are considered impaired when nonaccrual and principal or interest payments have been contractually past due for 90 days or more, unless the loan is both well-collateralized and in the process of collection; or they are classified as Troubled Debt Restructuring (TDR) loans to offer terms not typically granted by the Bank; or when current information or events make it unlikely to collect in full according to the contractual terms of the loan agreements; or there is a deterioration in the borrower s financial condition that raises uncertainty as to timely collection of either principal or interest; or full payment of both interest and principal is in doubt according to the original contractual terms.

We evaluate loan impairment in accordance with applicable GAAP. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or, as a practical expedient, at the loan s observable market price or the fair value of the collateral if the loan is collateral dependent, less costs to sell. If the measure of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the allowance for loan losses or, alternatively, a specific allocation will be established. Additionally, loans that are considered impaired are specifically excluded from the quarterly migration analysis when determining the amount of the allowance for loan losses required for the period.

The allowance for collateral-dependent loans is determined by calculating the difference between the outstanding loan balance and the value of the collateral as determined by recent appraisals. The allowance for collateral-dependent loans varies from loan to loan based on the collateral coverage of the loan at the time of designation as nonperforming. We continue to monitor the collateral coverage, using recent appraisals, on these loans on a quarterly basis and adjust the allowance accordingly.

Table of Contents

The following tables provide information on impaired loans (excluding PCI loans), disaggregated by loan class, as of the dates indicated:

	Recorded Investment	Unpaid Principal Balance	With No Related Allowance Recorded	With an Allowance Recorded	Related Allowance
			(In thousands)		
September 30, 2014					
Real estate loans:					
Commercial property					
Retail	$ 4,443	$ 4,543	$ 1,940	$ 2,503	$ 256
Hotel/Motel	4,042	4,855	4,042		1,261
Gas station	14,152	14,681	13,692	460	166
Other	9,856	11,266	8,518	1,338	344
Residential property	3,161	3,292	3,161		
Commercial and industrial loans:					
Commercial term	7,958	8,408	1,914	6,044	3,469
Commercial lines of credit	2,874	2,976	2,692	182	183
International loans	1,138	1,138	460	678	105
Consumer loans	1,758	1,910	1,758		
Total Non-PCI loans	**$ 49,382**	**$ 53,069**	**$ 38,177**	**$ 11,205**	**$ 5,784**
December 31, 2013					
Real estate loans:					
Commercial property					
Retail	$ 6,244	$ 6,332	$ 3,767	$ 2,477	$ 305
Hotel/Motel	6,200	6,940	4,668	1,532	1,183
Gas station	9,389	9,884	8,592	797	209
Other	11,451	12,882	9,555	1,896	351
Residential property	2,678	2,773	2,678		
Commercial and industrial loans:					
Commercial term	13,834	14,308	2,929	10,905	3,806
Commercial lines of credit	614	686	173	441	252
International loans	1,087	1,087	286	801	78
Consumer loans	1,569	1,671	644	925	284
Total Non-PCI loans	**$ 53,066**	**$ 56,563**	**$ 33,292**	**$ 19,774**	**$ 6,468**

Table of Contents

	Average Recorded Investment for the Three Months Ended	Interest Income Recognized for the Three Months Ended	Average Recorded Investment for the Nine Months Ended	Interest Income Recognized for the Nine Months Ended
		(In thousands)		
September 30, 2014				
Real estate loans:				
Commercial property				
Retail	$ 4,456	$ 36	$ 5,682	$ 215
Hotel/Motel	4,206	102	4,149	232
Gas station	14,181	218	12,023	587
Other	9,898	232	10,716	682
Residential property	3,173	30	2,853	87
Commercial and industrial loans:				
Commercial term	8,118	126	10,007	443
Commercial lines of credit	2,884	36	1,447	61
International loans	1,146		1,136	
Consumer loans	1,765	16	1,619	46
Total Non-PCI loans	**$ 49,827**	**$ 796**	**$ 49,632**	**$ 2,353**