HANMI FINANCIAL CORP
Form 10-K
March 01, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2006

or

o **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 ALos Angeles, California	**90010**
(Address of Principal Executive Offices)	*(Zip Code)*

(213) 382-2200
(Registrant s Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.001 Par Value	**The NASDAQ Global Market**

Securities Registered Pursuant to Section 12(g) of the Act:
None

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o   No þ

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o   No þ

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 þ   No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large Accelerated Filer þ   Accelerated Filer o   Non-Accelerated Filer o

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

As of June 30, 2006, the aggregate market value of the common stock held by non-affiliates of the Registrant was approximately $793,388,000. For purposes of the foregoing calculation only, in addition to affiliated companies, all directors and officers of the Registrant have been deemed affiliates.

Number of shares of common stock of the Registrant outstanding as of February 14, 2007 was 49,193,917 shares.

Documents Incorporated By Reference Herein: Registrant s Definitive Proxy Statement for its Annual Meeting of Stockholders, which will be filed within 120 days of the fiscal year ended December 31, 2006, is incorporated by reference into Part III of this report.

HANMI FINANCIAL CORPORATION

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

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FORWARD-LOOKING STATEMENTS

Some of the statements under *Item 1. Business,* *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations* and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expects, plans, intends, anticipates, believes, estimates, predicts, potential, or continue, or terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ from those expressed or implied by the forward-looking statement. For a discussion of some of the factors that might cause such a difference, see *Item 1A. Risk Factors,* *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations* *Interest Rate Risk Management* and *Liquidity and Capital Resources.* We undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made, except as required by law.

PART I

ITEM 1. *BUSINESS*

General

Hanmi Financial Corporation (Hanmi Financial, we or us) is a Delaware corporation incorporated on March 14, 2000 pursuant to a Plan of Reorganization and Agreement of Merger to be the holding company for Hanmi Bank (the Bank). Hanmi Financial became the holding company for the Bank in June 2000 and is subject to the Bank Holding Company Act of 1956, as amended (BHCA). Hanmi Financial also elected financial holding company status under the BHCA in 2000. Our principal office is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California 90010, and our telephone number is (213) 382-2200.

Hanmi Bank, our primary subsidiary, was incorporated under the laws of the State of California on August 24, 1981 and was licensed by the California Department of Financial Institutions (DFI) on December 15, 1982. The Bank s deposit accounts are insured under the Federal Deposit Insurance Act (FDI Act) up to applicable limits thereof, and the Bank is a member of the Federal Reserve System. The Bank s headquarters is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California 90010.

Hanmi Bank is a community bank conducting general business banking, with its primary market encompassing the Korean-American community as well as other communities in the multi-ethnic population of Los Angeles, Orange, San Diego, San Francisco and Santa Clara counties. The Bank s full-service offices are located in business areas where many of the businesses are run by immigrants and other minority groups. The Bank s client base reflects the multi-ethnic composition of these communities. At December 31, 2006, the Bank had 22 full-service branch offices in California and nine loan production offices in California, Colorado, Georgia, Illinois, Texas, Virginia and Washington.

Our revenues are derived primarily from interest on our loan and securities portfolios and service charges on deposit accounts. A summary of revenues for the periods indicated follows:

Year Ended December 31,

	2006		2005		2004	
			(Dollars in thousands)			
Interest and Fees on Loans	$ 239,075	80.8%	$ 180,845	78.2%	$ 117,999	72.9%
Interest on Investments	19,710	6.7%	18,507	8.0%	17,372	10.7%
Other Interest Income	1,404	0.5%	1,589	0.7%	183	0.1%
Service Charges on Deposit Accounts	17,134	5.8%	15,782	6.8%	14,441	8.9%
Other Non-Interest Income	18,470	6.2%	14,600	6.3%	11,770	7.4%
Total Revenues	**$ 295,793**	100.0%	**$ 231,323**	100.0%	**$ 161,765**	100.0%

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Business Acquisitions

In 2004, Hanmi Financial completed the acquisition of Pacific Union Bank (PUB), Los Angeles, California, and PUB was merged with Hanmi Bank.

Effective January 3, 2007, Hanmi Financial acquired two full-service insurance agencies, Chun-Ha Insurance Services, Inc. (Chun-Ha) and All World Insurance Services, Inc. (AWI), Garden Grove, California, as wholly-owned subsidiaries. The acquisition is not expected to have a significant effect on our financial position or results of operations.

Market Area

Hanmi Bank historically has provided its banking services through its branch network, located primarily in the Koreatown area of Los Angeles, to a wide variety of small- to medium-sized businesses. In recent years, it has expanded its service areas through de novo branching to Orange County, Santa Clara and San Diego and through acquisition to San Francisco and Seattle. Throughout the Bank s service area, competition is intense for both loans and deposits. While the market for banking services is dominated by a few nationwide banks with many offices operating over a wide geographic area, savings banks, thrift and loan associations, credit unions, mortgage companies, insurance companies and other lending institutions, the Bank s primary competitors are relatively smaller community banks that focus their marketing efforts on Korean-American businesses in the Bank s service areas. Substantially all of our assets are located in, and substantially all of our revenues are derived from clients located within, the State of California.

In 2005 and 2006, the Bank opened loan production offices in Atlanta, Chicago, Dallas, Denver and Annandale. These offices will expand our geographic coverage by providing commercial and industrial, real estate and Small Business Administration (SBA) loans. The Bank also has loan production offices in Los Angeles, California; the San Jose, California metropolitan area; and the Seattle, Washington metropolitan area. We plan to continue to expand our business services by opening additional loan production offices in selected locations throughout the United States. The Bank is a preferred SBA lender in the following SBA districts: California (Los Angeles, Santa Ana, San Diego, Fresno, San Francisco and Sacramento), Portland, Seattle, Anchorage, Denver, Texas (Dallas and Houston), Illinois, Georgia, Florida, Virginia, Washington, D.C., Maryland, New Jersey and New York.

Lending Activities

Hanmi Bank originates loans for its own portfolio and for sale in the secondary market. Lending activities include commercial loans, SBA guaranteed loans, loans secured by real estate (commercial mortgage loans, real estate construction loans and residential mortgage loans) and consumer loans.

Commercial Loans

Hanmi Bank offers commercial loans for intermediate and short-term credit. Commercial loans may be unsecured, partially secured or fully secured. The majority of the origination of commercial loans is in Los Angeles and Orange Counties, and loan maturities are normally 12 to 60 months. Hanmi Bank requires a credit underwriting before considering any extension of credit. The Bank finances primarily small and middle market businesses in a wide spectrum of industries. Commercial and industrial loans consist of credit lines for operating needs, loans for equipment purchases and working capital, and various other business purposes. As compared to consumer lending, commercial lending entails significant additional risks. These loans typically involve larger loan balances, are generally dependent on the business s cash flow and may be subject to adverse conditions in the general economy or in a specific industry. Short-term business loans generally are intended to finance current operations and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest.

In general, it is the intent of Hanmi Bank to take collateral whenever possible, regardless of the loan purpose(s). Collateral may include liens on inventory, accounts receivable, fixtures and equipment, leasehold improvements and real estate. When real estate is the primary collateral, the Bank obtains formal appraisals in

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accordance with applicable regulations to support the value of the real estate collateral. Typically, Hanmi Bank requires all principals of a business to be co-obligors on all loan instruments and all significant stockholders of corporations to execute a specific debt guaranty. All borrowers must demonstrate the ability to service and repay not only their obligations to Hanmi Bank debt, but also all outstanding business debt, without liquidating the collateral, based on historical earnings or reliable projections.

SBA Guaranteed Loans

Hanmi Bank originates loans qualifying for guarantees issued by the United States SBA, an independent agency of the Federal government. The SBA guarantees on such loans currently range from 75 percent to 85 percent of the principal and accrued interest. Under certain circumstances, the guarantee of principal and interest may be less than 75 percent. In general, the guaranteed percentage is less than 75 percent for loans over $1.3 million. Hanmi Bank typically requires that SBA loans be secured by business assets and by a first or second deed of trust on any available real property. When the loan is secured by a first deed of trust on real property, the Bank obtains appraisals in accordance with applicable regulations. SBA loans have terms ranging from five to twenty years depending on the use of the proceeds. To qualify for a SBA loan, a borrower must demonstrate the capacity to service and repay the loan, without liquidating the collateral, on the basis of historical earnings or reliable projections.

Hanmi Bank generally sells to unrelated third parties a substantial amount of the guaranteed portion of the SBA guaranteed loans that it originates. During the fourth quarter of 2006, the Bank began selling the unguaranteed portion of SBA loans. When Hanmi Bank sells a SBA loan, it may be obligated to repurchase the loan (for a period of 90 days after the sale) if the loan fails to comply with certain representations and warranties given by the Bank. The Bank is also obligated to repurchase the loan (before 120 days past due) if the loan is past due. Hanmi Bank retains the obligation to service the SBA loans, for which it receives servicing fees. The unsold portions of the SBA loans that remain owned by Hanmi Bank are included in Loans Receivable on the Consolidated Statements of Financial Condition. As of December 31, 2006, Hanmi Bank had $171.6 million in SBA loans in its portfolio, and was servicing $236.0 million of SBA loans sold to investors.

Loans Secured by Real Estate

Real estate lending involves risks associated with the potential decline in the value of the underlying real estate collateral and the cash flow from income-producing properties. Declines in real estate values and cash flows can be caused by a number of factors, including adversity in general economic conditions, rising interest rates, changes in tax and other laws and regulations affecting the holding of real estate, environmental conditions, governmental and other use restrictions, development of competitive properties and increasing vacancy rates. When real estate values decline, Hanmi Bank s real estate dependence increases the risk of loss both in Hanmi Bank s loan portfolio and any holdings of other real estate owned as a result of foreclosures on loans.

Commercial Mortgage Loans

Hanmi Bank offers commercial real estate loans. These loans are generally collateralized by first deeds of trust. For these commercial mortgage loans, the Bank obtains formal appraisals in accordance with applicable regulations to support the value of the real estate collateral. All appraisal reports on commercial mortgage loans are reviewed by an appraisal review officer. The review generally covers an examination of the appraiser s assumptions and methods that were used to derive a value for the property, as well as compliance with the Uniform Standards of Professional Appraisal Practice (the USPAP). Hanmi Bank also considers the cash flow from the business. The majority of the properties securing these loans are located in Los Angeles and Orange Counties.

Hanmi Bank s commercial real estate loans are principally secured by investor-owned commercial buildings and owner-occupied commercial and industrial buildings. Generally, these types of loans are made for a period of up to seven years, with monthly payments based upon a portion of the principal plus accrued interest, and with a loan-to-value ratio of 65 percent or less, using an adjustable rate indexed to the prime rate appearing in the West Coast edition of *The Wall Street Journal* (WSJ Prime Rate) or Hanmi Bank s prime rate (Bank Prime Rate), as adjusted from time to time. Hanmi Bank also offers fixed-rate commercial real estate loans, including hybrid-fixed

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rate loans that are fixed for one to five years and convert to adjustable rate loans for the remaining term. Amortization schedules for commercial real estate loans generally do not exceed 25 years.

Payments on loans secured by investor-owned and owner-occupied properties are often dependent upon successful operation or management of the properties. Repayment of such loans may be subject to a greater extent to the risk of adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks in a variety of ways, including limiting the size of such loans and strictly scrutinizing the property securing the loan. The Bank seeks to manage these risks in a variety of ways, including vacancy and interest rate hike sensitivity analysis at the time of loan origination and quarterly risk assessment of the total commercial real estate secured loan portfolio that includes most recent industry trends. When possible, the Bank also obtains corporate or individual guarantees from financially capable parties. Representatives of the Bank visit all of the properties securing the Bank s real estate loans before the loans are approved. The Bank requires title insurance insuring the status of its lien on all of the real estate secured loans when a first or second trust deed on the real estate is taken as collateral. The Bank also requires the borrower to maintain fire insurance, extended coverage casualty insurance and, if the property is in a flood zone, flood insurance, in an amount equal to the outstanding loan balance, subject to applicable laws that may limit the amount of hazard insurance a lender can require to replace such improvements. We cannot assure that these procedures will protect against losses on loans secured by real property.

Real Estate Construction Loans

Hanmi Bank finances the construction of multifamily, low-income housing, commercial and industrial properties within its market area. The future condition of the local economy could negatively affect the collateral values of such loans. The Bank s construction loans typically have the following characteristics:

- maturities of two years or less;
- a floating rate of interest based on the Bank Prime Rate or a nationally recognized index such as the WSJ Prime Rate;
- minimum cash equity of 35 percent of project cost;
- reserve of anticipated interest costs during construction or advance of fees;
- first lien position on the underlying real estate;
- loan-to-value ratios generally not exceeding 65 percent; and
- recourse against the borrower or a guarantor in the event of default.

Hanmi Bank does, on a case-by-case basis, commit to making permanent loans on the property with loan conditions that command strong project stability and debt service coverage. Construction loans involve additional risks compared to loans secured by existing improved real property. These include the following:

- the uncertain value of the project prior to completion;
- the inherent uncertainty in estimating construction costs, which are often beyond the borrower s control;
- construction delays and cost overruns;

possible difficulties encountered in connection with municipal or other governmental regulations during construction; and

the difficulty in accurately evaluating the market value of the completed project.

As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of the borrower or guarantor to repay principal and interest. If Hanmi Bank is forced to foreclose on a project prior to or at completion due to a default, there can be no assurance that Hanmi Bank will be able to recover all of the unpaid balance of, or accrued interest on, the loans as well as the related foreclosure and holding costs. In addition, Hanmi Bank may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminable period of time. Hanmi Bank has underwriting procedures designed to identify what it believes to be acceptable levels of risk in construction lending. Among other things, qualified and bonded third parties are engaged to provide progress reports and recommendations for construction disbursements. No assurance can be given that these procedures will prevent losses arising from the risks described above.

Residential Mortgage Loans

Hanmi Bank originates fixed-rate and variable-rate mortgage loans secured by one- to four-family properties with amortization schedules of 15 to 30 years and maturities of up to 30 years. The loan fees charged, interest rates and other provisions of the Bank s residential loans are determined by an analysis of the Bank s cost of funds, cost of origination, cost of servicing, risk factors and portfolio needs. The Bank may sell some of the mortgage loans that it originates to secondary market participants. The typical turn-around time from origination to sale is between 30 and 90 days. The interest rate and the price of the loan are typically agreed to prior to the loan origination.

Consumer Loans

Consumer loans are extended for a variety of purposes. Most are for the purchase of automobiles. Other consumer loans include secured and unsecured personal loans, home improvement loans, home equity lines of credit (HELOC s), overdraft protection loans, unsecured lines of credit and credit cards. Management assesses the borrower s creditworthiness and ability to repay the debt through a review of credit history and ratings, verification of employment and other income, review of debt-to-income ratios and other measures of repayment ability. Although creditworthiness of the applicant is of primary importance, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount. Most of Hanmi Bank s loans to individuals are repayable on an installment basis.

Any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance, because the collateral is more likely to suffer damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, the collection of loans to individuals is dependent on the borrower s continuing financial stability, and thus is more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, various Federal and state laws, including bankruptcy and insolvency laws, often limit the amount that the lender can recover on loans to individuals. Loans to individuals may also give rise to claims and defenses by a consumer borrower against the lender on these loans, and a borrower may be able to assert against any assignee of the note these claims and defenses that the borrower has against the seller of the underlying collateral.

Off-Balance Sheet Commitments

As part of its service to its small- to medium-sized business customers, Hanmi Bank from time to time issues formal commitments and lines of credit. These commitments can be either secured or unsecured. They may be in the form of revolving lines of credit for seasonal working capital needs or may take the form of commercial letters of credit or standby letters of credit. Commercial letters of credit facilitate import trade. Standby letters of credit are conditional commitments issued by Hanmi Bank to guarantee the performance of a customer to a third party.

Lending Procedures and Loan Limits

Loan applications may be approved by the Board of Directors Loan Committee, or by Hanmi Bank s management or lending officers to the extent of their lending authority. Individual lending authority is granted to the Chief Credit Officer, the Deputy Chief Credit Officer and the Senior Credit Officer. In early 2006, the Bank granted lending authority to certain additional officers including Branch Managers and the line managers to whom they report. Loans for which direct and indirect borrower liability exceeds an individual s lending authority are referred to Hanmi Bank s

Management Credit Committee and, for those in excess of the Management Credit Committee s approval limits, to the Board of Directors Loan Committee.

At December 31, 2006, Hanmi Bank s authorized legal lending limits for loans to one borrower were $56.5 million for unsecured loans plus an additional $37.6 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount that exceeds 15 percent of primary capital plus the allowance for

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loan losses on an unsecured basis, plus an additional 10 percent on a secured basis. Hanmi Bank s primary capital plus allowance for loan losses at December 31, 2006 totaled $376.4 million.

Hanmi Bank seeks to mitigate the risks inherent in its loan portfolio by adhering to certain underwriting practices. The review of each loan application includes analysis of the applicant s experience, prior credit history, income level, cash flow, financial condition, tax returns, cash flow projections, and the value of any collateral to secure the loan, based upon reports of independent appraisers and/or audits of accounts receivable or inventory pledged as security. In the case of real estate loans over a specified amount, the review of collateral value includes an appraisal report prepared by an independent Bank-approved appraiser. All appraisal reports on commercial real property secured loans are reviewed by an Appraisal Review Officer. The review generally covers an examination of the appraiser s assumptions and methods that were used to derive a value for the property, as well as compliance with the USPAP.

Allowance for Loan Losses, Allowance for Off-Balance Sheet Items and Provision for Credit Losses

Hanmi Bank maintains an allowance for loan losses at a level considered by management to be adequate to cover the inherent risks of loss associated with its loan portfolio under prevailing economic conditions. In addition, the Bank maintains an allowance for off-balance sheet items associated with unfunded commitments and letters of credit, which is included in Other Liabilities on the Consolidated Statements of Financial Condition.

Hanmi Bank follows the *Interagency Policy Statement on the Allowance for Loan and Lease Losses* and analyzes the allowance for loan losses on a quarterly basis. In addition, as an integral part of the quarterly credit review process of the Bank, the allowance for loan losses and allowance for off-balance sheet items are reviewed for adequacy. The DFI and/or the Board of Governors of the Federal Reserve System (the FRB) require the Bank to recognize additions to the allowance for loan losses based upon their assessment of the information available to them at the time of their examinations.

Deposits

We raise funds primarily through Hanmi Bank s network of branches. The Bank attracts deposits by offering a wide variety of transaction and term accounts and personalized customer service. Accounts offered include business and personal checking accounts, savings accounts, negotiable order of withdrawal (NOW) accounts, money market accounts and certificates of deposit.

Website

We maintain an Internet website at *www.hanmi.com.* We make available free of charge on the website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments thereto, as soon as reasonably practicable after we file such reports with the Securities and Exchange Commission (SEC or the Commission). None of the information on or hyperlinked from our website is incorporated into this Annual Report on Form 10-K.

Employees

As of December 31, 2006, we had 589 full-time equivalent employees. Our employees are not represented by a union or covered by a collective bargaining agreement.

Insurance

We maintain financial institution bond and commercial insurance at levels deemed adequate by management to protect Hanmi Financial from certain damages.

Competition

The banking and financial services industry in California generally, and in Hanmi Bank s market areas specifically, are highly competitive. The increasingly competitive environment faced by banks is a result primarily of changes in laws and regulation, changes in technology and product delivery systems, new competitors in the market, and the accelerating pace of consolidation among financial service providers. We compete for loans, deposits and customers with other commercial banks, savings institutions, securities and brokerage companies, mortgage companies, real estate investment trusts, insurance companies, finance companies, money market funds, credit unions and other non-bank financial service providers. Some of these competitors are larger in total assets and capitalization, have greater access to capital markets, including foreign-ownership, and/or offer a broader range of financial services.

Among the advantages that the major banks have over Hanmi Bank is their ability to finance extensive advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Many of the major commercial banks operating in Hanmi Bank s service areas offer specific services (for instance, trust services) that are not offered directly by Hanmi Bank. By virtue of their greater total capitalization, these banks also have substantially higher lending limits than Hanmi Bank does.

The recent trend has been for other institutions, including brokerage firms, credit card companies and retail establishments, to offer banking services to consumers, including money market funds with check access and cash advances on credit card accounts. In addition, other entities (both public and private) seeking to raise capital through the issuance and sale of debt or equity securities compete with banks in the acquisition of deposits.

Hanmi Bank s major competitors are relatively smaller community banks that focus their marketing efforts on Korean-American businesses in Hanmi Bank s service areas. Amongst these banks, Hanmi Bank is the largest, with a loan portfolio that is 67.3 percent larger than its nearest competitor s loan portfolio, and a deposit portfolio that is 68.1 percent larger than its nearest competitor s deposit portfolio. These banks compete for loans primarily through the interest rates and fees they charge and the convenience and quality of service they provide to borrowers. The principal bases of competition for deposits are the interest rate paid, convenience and service.

In order to compete with other financial institutions in its service area, Hanmi Bank relies principally upon local promotional activity, including advertising in the local media, personal contacts, direct mail and specialized services. The Bank s promotional activities emphasize the advantages of dealing with a locally owned and headquartered institution attuned to the particular needs of the community.

Economic Conditions, Government Policies, Legislation and Regulation

Our profitability, like that of most financial institutions, is primarily dependent on interest rate differentials. In general, the difference between the interest rates paid by us on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by us on our interest-earning assets, such as loans extended to our customers and securities held in our investment portfolio, will comprise the major portion of our earnings. These rates are highly sensitive to many factors that are beyond our control, such as inflation, recession and unemployment, and the impact that future changes in domestic and foreign economic conditions might have on us cannot be predicted.

Our business is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) through its open-market operations in U.S. Government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target federal funds and discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest earned on interest-earning assets and interest paid on interest-bearing liabilities. The nature and impact on us of any future changes in monetary and fiscal policies cannot be predicted.

From time to time, federal and state legislation is enacted which may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers, such as recent federal legislation permitting affiliations among commercial banks, insurance companies and securities firms. We cannot predict whether or when any potential legislation will be enacted, and if enacted, the effect that it, or any implementing regulations, would have on our financial condition or results of operations. In addition, the outcome of any investigations initiated by state authorities or litigation raising issues may result in necessary changes in our operations, additional regulation and increased compliance costs.

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Supervision and Regulation

General

We are extensively regulated under both Federal and certain state laws. Regulation and supervision by the federal and state banking agencies is intended primarily for the protection of depositors and the Deposit Insurance Fund (DIF) administered by the Federal Deposit Insurance Corporation (FDIC), and not for the benefit of stockholders. Set forth below is a summary description of the key laws and regulations that relate to our operations. These descriptions are qualified in their entirety by reference to the applicable laws and regulations.

Hanmi Financial

As a financial holding company, we are subject to regulation and examination by the FRB under the BHCA. We are required to file with the FRB periodic reports and such additional information as the FRB may require.

The FRB may require us to terminate an activity or terminate control of, liquidate or divest certain subsidiaries, affiliates or investments if the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of our banking subsidiary. The FRB also has the authority to regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt. Under certain circumstances, we must file written notice and obtain FRB approval prior to purchasing or redeeming our equity securities. Further, we are required by the FRB to maintain certain levels of capital. See *Capital Standards.*

We are required to obtain prior FRB approval for the acquisition of more than five percent of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior FRB approval is also required for the merger or consolidation of a bank holding company with another bank holding company. Similar state banking agency approvals may also be required. Certain competitive, management, financial and other factors are considered by the bank regulatory agencies in granting these approvals.

We are prohibited by the BHCA, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than five percent of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to subsidiaries. However, subject to prior notice or FRB approval, we may engage in any, or acquire shares of companies engaged in, those non-banking activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. We may make acquisitions and engage in these non-banking and certain other activities without prior FRB approval pursuant to our election as a financial holding company.

FRB regulations require that each bank holding company serve as a source of financial and managerial strength to its subsidiary bank(s) and commit resources as necessary to support each subsidiary bank. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of FRB regulations or both. The FRB s bank holding company rating system emphasizes risk management and evaluation of the potential impact of non-depository entities on safety and soundness.

We are also a bank holding company within the meaning of the California Financial Code. As such, Hanmi Financial and our subsidiary are subject to examination by, and may be required to file reports with, the DFI.

Financial Holding Status

In order to elect or retain financial holding company status, our depository institution subsidiary must be well-capitalized, well-managed, and, except in limited circumstances, in satisfactory compliance with the Community Reinvestment Act (CRA). Failure to sustain compliance with these requirements or correct any non-compliance within a fixed time period could lead to divestiture of subsidiary banks or require us to conform all of our activities to those permissible for a bank holding company. We elected financial holding company status in 2000.

As a bank holding company that has elected to be a financial holding company, we may affiliate with securities firms and insurance companies and engage in other activities, without prior FRB notice or approval, that are determined to be financial in nature or are incidental or complementary to activities that are financial in nature. Financial in nature activities include:

- lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;
- providing any device or other instrumentality for transferring money or other financial assets;
- arranging, effecting or facilitating financial transactions for the account of third parties;
- securities underwriting;
- dealing and market making;
- sponsoring mutual funds and investment companies;
- insurance underwriting and agency sales;
- merchant banking investments; and
- activities that the FRB, in consultation with the Secretary of the Treasury, determines from time to time to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Bank

As a California chartered bank that is a member of the Federal Reserve, we are subject to primary supervision, periodic examination and regulation by the DFI and the FRB through the Federal Reserve Bank of San Francisco, as well as certain regulations promulgated by the FDIC. If, as a result of an examination of the Bank, the FRB or DFI determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of our banking operations are unsatisfactory or that the Bank is violating or has violated any law or regulation, various remedies are available to the FRB, including the power to require affirmative action to correct any conditions resulting from any violation or practice; enter into informal non-public or formal public memoranda of understanding or written agreements with the Bank to take corrective action; issue an administrative order that can be judicially enforced; enjoin unsafe or unsound practices; direct an increase in capital; restrict our growth; assess civil monetary penalties; and remove officers and directors. Ultimately, the DFI could take possession and close and liquidate the Bank.

The DFI also possesses broad powers to take corrective and other supervisory actions to resolve the problems of California state-chartered banks. These enforcement powers include cease and desist orders, the imposition of fines, the ability to take possession of a bank and the ability to close and liquidate a bank.

Changes, such as the following, in Federal or state banking laws or the regulations, policies or guidance of the Federal or state banking agencies could have a material adverse impact on us, the Bank and our operations:

- In December 2006, the Federal banking agencies issued final guidance to reinforce sound risk management practices for bank holding companies and banks in commercial real estate (CRE) loans which establishes CRE concentration thresholds as criteria for examiners to identify CRE concentration that may warrant further analysis. The implementation of these guidelines could result in increased reserves and capital costs for banks with CRE concentration. As of December 31, 2006, the Bank s CRE portfolio would not meet the definition of

CRE concentration as set forth in the guidelines.

In September 2006, the Federal banking agencies issued final guidance on alternative residential mortgage products that allow borrowers to defer repayment of principal and sometimes interest, including interest-only mortgage loans, and payment option adjustable rate mortgages where a borrower has flexible payment options, including payments that have the potential for negative amortization. While acknowledging that innovations in mortgage lending can benefit some consumers, the final guidance states that management should (1) assess a borrower s ability to repay the loan, including any principal balances added through negative amortization, at the fully indexed rate that would apply after the introductory period, (2) recognize that certain nontraditional mortgages are untested in a stressed environment and warrant strong risk management standards as well as appropriate capital and loan loss reserves, and (3) ensure that borrowers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice. The Bank believes its products and disclosures are in conformance with the requirements of the guidance.

Pursuant to the Financial Services Regulatory Relief Act of 2006, the SEC and the FRB have released, as Regulation R, joint proposed rules expected to be finalized by midyear to implement exceptions provided for in the Gramm-Leach-Bliley Act for bank securities activities which banks may conduct without registering with the SEC as securities brokers or moving such activities to a broker-dealer affiliate. The proposed Regulation R push out rules exceptions would allow a bank, subject to certain conditions, to continue to conduct securities transactions for customers as part of the bank s trust and fiduciary, custodial and deposit sweep functions, and to refer customers to a securities broker-dealer pursuant to a networking arrangement with the broker-dealer. The proposed rules, if adopted, are not expected to have a material effect on the current securities activities which the Bank now conducts for customers.

Because California permits commercial banks chartered by the state to engage in any activity permissible for national banks, the Bank may form subsidiaries to engage in the many so-called closely related to banking or non-banking activities commonly conducted by national banks in operating subsidiaries, and may conduct certain financial activities in a subsidiary to the same extent as may a national bank. However, in order to form a financial subsidiary, the Bank must be well-capitalized, well-managed and in satisfactory compliance with the CRA. Further, the Bank must exclude from its assets and equity all equity investments, including retained earnings, in a financial subsidiary. The assets of the subsidiary may not be consolidated with the Bank s assets. The Bank must also have policies and procedures to assess financial subsidiary risk and protect the Bank from such risks and potential liabilities and would be subject to the same capital deduction, risk management and affiliate transaction rules as applicable to national banks. Generally, a financial subsidiary is permitted to engage in activities that are financial in nature or incidental thereto, even though they are not permissible for the national bank to conduct directly within the Bank. The definition of financial in nature includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, under present law, engage as principal in underwriting insurance (other than credit life insurance), issue annuities or engage in real estate brokerage or in merchant banking activities. Chun-Ha and AWI are financial subsidiaries of Hanmi Financial.

Federal Home Loan Bank (FHLB) System

The Bank is a member of the FHLB of San Francisco. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As a FHLB member, we are required to own a certain amount of capital stock in the FHLB. At December 31, 2006, we were in compliance with the stock requirements.

Interstate Banking and Branching

Subject to certain size limitations under the Riegle-Neal Interstate Banking Act, bank holding companies and banks have the ability to acquire and merge with banks in other states; and, subject to certain state restrictions, banks may also acquire or establish new branches outside their home states. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addressed accounting oversight and corporate governance matters, and, among other things:

- required executive certification of financial presentations;
- increased requirements for board audit committees and their members;

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- enhanced disclosure of controls and procedures and internal control over financial reporting;
- enhanced controls on, and reporting of, insider trading; and
- increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances.

The legislation and its implementing regulations have resulted in increased costs of compliance, including certain outside professional costs. To date, these costs have not had a material impact on our operations.

Dividends and Other Transfers of Funds

Dividends from the Bank constitute the principal source of income to Hanmi Financial, which is a legal entity separate and distinct from the Bank. A FRB policy statement on the payment of cash dividends states that a bank holding company should pay cash dividends only to the extent that the holding company s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company s capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, under the Federal prompt corrective action regulations, the FRB may prohibit a bank holding company from paying any dividends if the holding company s bank subsidiary is classified as undercapitalized. See *Capital Standards* below.

The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends. Under such restrictions, the amount available for payment of dividends to Hanmi Financial by the Bank totaled $131.0 million at December 31, 2006. In addition, the Bank s regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank s financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

Capital Standards

The Federal banking agencies have adopted risk-based minimum capital guidelines for bank holding companies and banks that are intended to provide a measure of capital that reflects the degree of risk associated with a banking organization s operations for both transactions reported on the balance sheet as assets and transactions which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from zero percent for assets with low credit risk, such as certain U.S. Treasury securities, to 100 percent for assets with relatively high credit risk, such as business loans.

Under the capital guidelines, a banking organization s total capital is divided into tiers. Tier I capital consists of (1) common equity, (2) qualifying non-cumulative perpetual preferred stock, (3) a limited amount of qualifying cumulative perpetual preferred stock and (4) minority interests in the equity accounts of consolidated subsidiaries (including trust-preferred securities), less goodwill and certain other intangible assets. Qualifying Tier I capital may consist of trust-preferred securities, subject to the FRB s final rule adopted March 4, 2005, which changed the criteria and quantitative limits for inclusion of restricted core capital elements in Tier I capital. Tier II capital consists of hybrid capital instruments, perpetual debt, mandatory convertible debt securities, a limited amount of subordinated debt, preferred stock and trust-preferred securities that do not qualify as Tier I capital, a limited amount of the allowance for loan and lease losses and a limited amount of unrealized holding gains on equity securities. Tier III capital consists of qualifying unsecured subordinated debt. The sum of Tier II and Tier III capital may not exceed the amount of Tier I capital.

The risk-based capital guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8.0 percent and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4.0 percent. In addition to the risk-based guidelines, Federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3.0 percent.

As of December 31, 2006, the regulatory capital guidelines and the actual capital ratios for Hanmi Financial and the Bank were as follows:

	Requirement		Actual as of December 31, 2006	
	Adequately Capitalized	Well Capitalized	Hanmi Bank	Hanmi Financial
Total Risk-Based Capital Ratio	8.0%	10.0%	12.28%	12.55%
Tier 1 Risk-Based Capital Ratio	4.0%	6.0%	11.31%	11.58%
Tier 1 Leverage Capital Ratio	4.0%	5.0%	9.85%	10.08%

The current risk-based capital guidelines are based upon the 1988 capital accord of the International Basel Committee on Banking Supervision. A new international accord, referred to as Basel II, which emphasizes internal assessment of credit, market and operational risk, supervisory assessment and market discipline in determining minimum capital requirements, currently becomes mandatory outside the U.S. in 2008. In October 2006, the U.S. federal banking agencies issued a notice of proposed rulemaking for comment to implement Basel II for U.S. banks with certain differences from the international Basel II framework and which would not be fully in effect for U.S. banks until 2012. Further, the U.S. banking agencies propose to retain the minimum leverage requirement and prompt corrective action regulatory standards. In December 2006, the federal banking agencies issued another notice of proposed rulemaking for comment, referred to as Basel IA, which proposed alternative capital requirements for smaller U.S. banks that may be negatively impacted competitively by certain provisions of Basel II. Additional guidance on Basel II issued in February 2007 stated the agencies expectation that to determine the extent to which banks should hold capital in excess of regulatory minimum levels, examiners would examine the combined implications of a bank s compliance with qualification requirements for regulatory risk-based capital standards, the quality and results of the bank s internal capital adequacy assessment process, and the examiners assessment of the bank s risk profile and capital position. At this time, the impact that proposed changes in capital requirements may have on the cost and availability of different types of credit and the compliance cost of implementing Basel II or Basel IA, as applicable, are uncertain.

The federal banking agencies possess broad power under the FDI Act to take prompt corrective action to resolve the problems of insured depository institutions that fall within any undercapitalized category. In addition, the federal banking agencies have adopted non-capital safety and soundness standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset quality and growth, (v) earnings, (vi) risk management, and (vii) compensation and benefits.

Premiums for Deposit Insurance

Through the DIF, the FDIC insures our customer deposits up to prescribed limits for each depositor. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other factors. Specifically, the assessment rate is based on the institution s capitalization risk category and supervisory subgroup category. An institution s capitalization risk category is based on the FDIC s determination of whether the institution is well capitalized, adequately capitalized or less than adequately capitalized. An institution s supervisory subgroup category is based on the FDIC s assessment of the financial condition of the institution and the probability that FDIC intervention or other corrective action will be required.

The assessment rate currently ranges from zero to 27 cents per $100 of domestic deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. Due principally to continued growth in deposits, the

BIF is nearing its minimum ratio of 1.25 percent of insured deposits as mandated by law. The Federal Deposit Insurance Reform Act of 2006 (FDIRA) provided, among other things, for changes in the formula and factors to be considered by the FDIC in calculating the FDIC reserve ratio, assessments and dividends, and a one-time aggregate assessment credit for depository institutions in existence on December 31, 1996 (or their successors) which paid assessments to recapitalize the insurance funds after the banking crises of the late 1980s and early 1990s. The FDIC issued final regulations, effective January 1, 2007, implementing the provisions of FDIRA and, in February 2007, issued for comment guidelines, including business line concentrations and risk of failure and severity of loss in the event of failure to be used by the FDIC for possibly raising premiums by up to 0.50 basis points for large banks with $10 billion or more in assets.

The FDIC may terminate a depository institution s deposit insurance upon a finding by the FDIC that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or they may prejudice the interests of the bank s depositors. The termination of deposit insurance for the Bank also result in the revocation of the Bank s charter by the DFI.

All FDIC-insured depository institutions must also pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a Federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, commonly referred to as FICO bonds, were issued to capitalize the Federal Savings and Loan Insurance Corporation. The FICO assessment rate for the fourth quarter of fiscal 2006 was 1.24 basis points for each $100 of assessable deposits. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC s insurance funds and do not vary depending on a depository institution s capitalization or supervisory evaluations.

Extensions of Credit to Insiders and Transactions with Affiliates

The Federal Reserve Act and FRB Regulation O place limitations and conditions on loans or extensions of credit to:

- a bank s or bank holding company s executive officers, directors and principal shareholders (i.e., in most cases, those persons who own, control or have power to vote more than 10 percent of any class of voting securities);
- any company controlled by any such executive officer, director or shareholder; or
- any political or campaign committee controlled by such executive officer, director or principal shareholder.

Loans and leases extended to any of the above persons must comply with the loan-to-one-borrower limits, require prior full board approval when aggregate extensions of credit to the person exceed specified amounts, must be made on substantially the same terms (including interest rates and collateral) as, and follow credit-underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with non-insiders, and must not involve more than the normal risk of repayment or present other unfavorable features. In addition, Regulation O provides that the aggregate limit on extensions of credit to all insiders of a bank as a group cannot exceed the bank s unimpaired capital and unimpaired surplus. Regulation O also prohibits a bank from paying an overdraft on an account of an executive officer or director, except pursuant to a written pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the officer or director at the bank.

The Bank also is subject to certain restrictions imposed by Federal Reserve Act Sections 23A and 23B and FRB Regulation W on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of, any affiliates, the purchase of, or investments in, stock or other securities thereof, the taking of such securities as collateral for loans, and the purchase of assets of any affiliates. Such restrictions prevent any affiliates from borrowing from the Bank unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments to or in any affiliate are limited, individually, to 10.0 percent of our capital and surplus (as defined by Federal regulations), and such secured loans and investments are limited, in the aggregate, to 20.0 percent of our capital and surplus. Some of the entities included in the definition of an affiliate are parent companies, sister banks, sponsored and advised companies, investment companies whereby the Bank s affiliate serves as investment advisor, and financial subsidiaries of the Bank. Additional restrictions on transactions with affiliates may be imposed on us under the prompt corrective action provisions of Federal law and the supervisory authority of the Federal and state banking agencies.

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USA PATRIOT Act

The USA PATRIOT Act of 2001 and its implementing regulations significantly expanded the anti-money laundering and financial transparency laws. Under the USA PATRIOT Act, financial institutions are required to establish and maintain anti-money laundering programs, which include:

- the establishment of a customer identification program;
- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;
- an ongoing employee training program; and
- an independent audit function to test the programs.

The Bank has adopted comprehensive policies and procedures to address the requirements of the USA PATRIOT Act. Material deficiencies in anti-money laundering compliance can result in public enforcement actions by the banking agencies, including the imposition of civil money penalties and supervisory restrictions on growth and expansion. Such enforcement actions could have serious reputation consequences for Hanmi Financial and the Bank.

Consumer Laws

Examination and enforcement by the bank regulatory agencies for non-compliance with consumer protection laws and their implementing regulations have become more intense in nature. The Bank is subject to many Federal consumer protection statutes and regulations, some of which are discussed below.

The Home Ownership and Equal Protection Act of 1994 (HOEPA) requires extra disclosures and consumer protections to borrowers for certain lending practices. The term predatory lending, much like the terms safety and soundness and unfair and deceptive practices, is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. Typically, predatory lending involves at least one, and perhaps all three, of the following elements:

- making unaffordable loans based on the assets of the borrower rather than on the borrower s ability to repay an obligation (asset-based lending);
- inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced (loan flipping); and/or
- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Regulatory and banking agency guidelines aimed at curbing predatory lending significantly widen the pool of high cost home secured loans covered by HOEPA. In addition, the regulations bar certain refinances within a year with another loan subject to HOEPA by the same lender or loan servicer. Lenders also will be presumed to have violated the law which says loans should not be made to people unable to repay them unless they document that the borrower has the ability to repay. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid. We do not expect these rules and potential state action in this area to have a material impact on our financial condition or results of operation.

Privacy policies are required by Federal banking regulations that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. Pursuant to those rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public personal information to non-affiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and
- a reasonable method for customers to "opt out" of disclosures to non-affiliated third parties.

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These privacy protections affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

In addition, state laws may impose more restrictive limitations on the ability of financial institution to disclose such information. California has adopted such a privacy law that among other things generally provides that customers must opt in before information may be disclosed to certain non-affiliated third parties.

The Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act (FACT Act), requires financial firms to help deter identity theft, including developing appropriate fraud response programs, and gives consumers more control of their credit data. It also reauthorizes a Federal ban on state laws that interfere with corporate credit granting and marketing practices. In connection with FACT Act, financial institution regulatory agencies proposed rules that would prohibit an institution from using certain information about a consumer it received from an affiliate to make a solicitation to the consumer, unless the consumer has been notified and given a chance to opt out of such solicitations. A consumer s election to opt out would be applicable for at least five years.

The Check Clearing for the 21st Century Act (Check 21) facilitates check truncation and electronic check exchange by authorizing a new negotiable instrument called a substitute check, which is the legal equivalent of an original check. Check 21 does not require banks to create substitute checks or accept checks electronically; however, it does require banks to accept a legally equivalent substitute check in place of an original. In addition to its issuance of regulations governing substitute checks, the Federal Reserve has issued final rules governing the treatment of remotely created checks (sometimes referred to as demand drafts) and electronic check conversion transactions (involving checks that are converted to electronic transactions by merchants and other payees).

The Equal Credit Opportunity Act (ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The Truth in Lending Act (TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The Fair Housing Act (FH Act) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The CRA is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the Federal regulatory agencies, in examining insured depository institutions, to assess a bank s record of helping meet the credit needs of its entire community, including low-and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution s record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, mergers or acquisitions, or holding company formations. The agencies use the CRA assessment factors in order to provide a rating to the financial institution. The ratings range from a high of outstanding to a low of substantial non-compliance. In its last examination for CRA compliance, as of August 30, 2004, the Bank was rated Satisfactory.

The Home Mortgage Disclosure Act (HMDA) grew out of public concern over credit shortages in certain urban neighborhoods and provides public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a fair lending aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes. The Federal Reserve Board amended regulations issued under HMDA to require the reporting for 2004 of certain pricing data with respect to higher priced mortgage loans. The expanded 2004 HMDA data is being reviewed by Federal banking agencies and others from a fair lending perspective. We do not expect that the HMDA data reported by the Bank for 2005 will raise material issues regarding the Bank s compliance with the fair lending laws.

The Real Estate Settlement Procedures Act (RESPA) requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Penalties under the above laws may include fines, reimbursements and other penalties.

The National Flood Insurance Act (NFIA) requires homes in flood-prone areas with mortgages from a federally regulated lender to have flood insurance. Hurricane Katrina focused awareness on this requirement. Lenders are required to provide notice to borrowers of special flood hazard areas and require such coverage before making, increasing, extending or renewing such loans. Financial institutions that demonstrate a pattern and practice of lax compliance are subject to the issuance of cease and desist orders and the imposition of per loan civil money penalties, up to a maximum fine, which currently is $125,000. Fine payments are remitted to the Federal Emergency Management Agency for deposit into the National Flood Mitigation Fund.

Due to heightened regulatory concern related to compliance with HOEPA, privacy laws and regulations, FACT, Check 21, ECOA, TILA, FH Act, CRA, HMDA, RESPA and NFIA generally, the Bank may incur additional compliance costs or be required to expend additional funds for CRA investments.

Regulation of Subsidiaries

Non-bank subsidiaries are subject to additional or separate regulation and supervision by other state, Federal and self-regulatory bodies. Chun-Ha and AWI are subject to the licensing and supervisory authority of the California Commissioner of Insurance.

ITEM 1A. *RISK FACTORS*

In addition to other factors set forth herein, below is a discussion of certain factors that may affect our financial operations and should be considered in evaluating us:

Our Southern California business focus and economic conditions in Southern California could adversely affect our operations. The Bank s operations are located primarily in Los Angeles and Orange counties. Because of this geographic concentration, our results depend largely upon economic conditions in these areas. Deterioration in economic conditions in the Bank s market area, or a significant natural or man-made disaster in these market areas, could have a material adverse effect on the quality of the Bank s loan portfolio, the demand for its products and services and on its overall financial condition and results of operations.

Our concentrations in commercial real estate loans located primarily in Southern California could have adverse effects on credit quality. Approximately 33.5 percent of the Bank s loan portfolio consists of commercial real estate and construction loans, primarily in Southern California. As a result of this concentration, a deterioration of the Southern California commercial real estate market could have adverse consequences for the Bank. Among the factors that could contribute to such a decline are general economic conditions in Southern California, interest rates and local market construction and sales activity.

Our earnings are affected by changing interest rates. Changes in interest rates affect the level of loans, deposits and investments, the credit profile of existing loans, the rates received on loans and securities and the rates paid on deposits and borrowings. Significant fluctuations in interest rates may have a material adverse effect on our financial condition and results of operations.

We are subject to government regulations that could limit or restrict our activities, which in turn could adversely affect our operations. The financial services industry is subject to extensive Federal and state supervision and regulation. Significant new laws, changes in existing laws, or repeals of existing laws may cause our results to differ materially. Further, Federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions and a material change in these conditions could have a material adverse affect on our financial condition and results of operations.

Competition may adversely affect our performance. The banking and financial services businesses in our market areas are highly competitive. We face competition in attracting deposits, in making loans and attracting and retaining employees. The increasingly competitive environment is a result of changes in regulation, changes in technology and product delivery systems, new competitors in the market, and the pace of consolidation among financial services providers. Our results in the future may differ depending upon the nature and level of competition.

If a significant number of borrowers, guarantors or related parties fail to perform as required by the terms of their loans, we could sustain losses. A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors or related parties may fail to perform in accordance with the terms of their loans. We have adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to limit this risk by assessing the likelihood of non-performance, tracking loan performance and diversifying our credit portfolio. These policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on our financial condition and results of operations.

ITEM 1B. *UNRESOLVED STAFF COMMENTS*

None.

ITEM 2. *PROPERTIES*

Hanmi Financial s principal office is located at 3660 Wilshire Boulevard, Penthouse Suite A, Los Angeles, California. The office is leased pursuant to a five-year term, which expires on November 30, 2008.

The following table sets forth information about our offices:

Office	Type of Office	Address	City/State	Owned/ Leased
Corporate Headquarters	Headquarters(1)	3660 Wilshire Boulevard, Penthouse Suite A	Los Angeles, CA	Leased
Cerritos Branch	Branch	11754 East Artesia Boulevard	Artesia, CA	Leased
Downtown Branch	Branch	950 South Los Angeles Street	Los Angeles, CA	Leased
Fashion District Branch	Branch	726 East 12th Street, Suite 211	Los Angeles, CA	Leased
Garden Grove Branch	Branch	9820 Garden Grove Boulevard	Garden Grove, CA	Owned
Gardena Branch	Branch	2001 West Redondo Beach Boulevard	Gardena, CA	Leased
Irvine Branch	Branch	14474 Culver Drive, Suite D	Irvine, CA	Leased
Koreatown Galleria Branch	Branch	3250 West Olympic Boulevard, Suite 200	Los Angeles, CA	Leased
Koreatown Plaza Branch	Branch(2)	928 South Western Avenue, Suite 260	Los Angeles, CA	Leased
Mid-Olympic Branch	Branch(3)	3099 West Olympic Boulevard	Los Angeles, CA	Owned
Olympic Branch	Branch(4)	3737 West Olympic Boulevard	Los Angeles, CA	Owned

Rowland Heights Branch	Branch	18720 East Colima Road	Rowland Heights, CA	Leased
San Diego Branch	Branch	4637 Convoy Street, Suite 101	San Diego, CA	Leased
San Francisco Branch	Branch	1491 Webster Street	San Francisco, CA	Leased
Silicon Valley Branch	Branch	2765 El Camino Real	Santa Clara, CA	Leased
South Cerritos Branch	Branch	11900 South Street, Suite 109	Cerritos, CA	Leased
Torrance Branch	Branch	2370 Crenshaw Boulevard, Suite H	Torrance, CA	Leased
Van Nuys Branch	Branch	14427 Sherman Way	Van Nuys, CA	Leased
Vermont Branch	Branch(5)	933 South Vermont Avenue	Los Angeles, CA	Owned
West Garden Grove Branch	Branch	9122 Garden Grove Boulevard	Garden Grove, CA	Owned
West Torrance Branch	Branch	21838 Hawthorne Boulevard	Torrance, CA	Leased
Western Branch	Branch	120 South Western Avenue	Los Angeles, CA	Leased
Wilshire Branch	Main Branch(6)	3660 Wilshire Boulevard, Suite 103	Los Angeles, CA	Leased
Commercial Loan Department	Loan Office(1)	3660 Wilshire Boulevard, Suite 1050	Los Angeles, CA	Leased
SBA Loan Department	Loan Office(1)	3327 Wilshire Boulevard	Los Angeles, CA	Leased
Atlanta LPO	Loan Office(1)	3585 Peachtree Industrial Boulevard, Suite 144	Duluth, GA	Leased
Chicago LPO	Loan Office(1)	6200 North Hiawatha, Suite 235	Chicago, IL	Leased
Dallas LPO	Loan Office(1)	2711 LBJ Freeway, Suite 114	Farmers Branch, TX	Leased

Office	Type of Office	Address	City/State	Owned/ Leased
Denver LPO	Loan Office(1)	3033 South Parker Road, Suite 340	Aurora, CO	Leased
Northern California LPO	Loan Office(1)	39899 Balentine Drive, Suite 200	Newark, CA	Leased
Northwest Region LPO No. 1	Loan Office(1)	33110 Pacific Highway South, Suite 4	Federal Way, WA	Leased
Northwest Region LPO No. 2	Loan Office(1)	3500 108th Avenue Northeast, Suite 280	Bellevue, WA	Leased
Virginia LPO	Loan Office(1)	7535 Little River Turnpike, Suite 200B	Annandale, VA	Leased

(1) *Deposits are not accepted at this facility.*

(2) *Residential Mortgage Center is also located at this facility.*

(3) *Auto Loan Center and Consumer Loan Center are also located at this facility.*

(4) *Training Facility is also located at this facility.*

(5) *Administrative offices are also located at this facility.*

(6) *International Finance Department is also located at this facility.*

Hanmi Financial and Hanmi Bank consider their present facilities to be sufficient for their current operations.

ITEM 3. *LEGAL PROCEEDINGS*

From time to time, Hanmi Financial and Hanmi Bank are parties to litigation that arises in the ordinary course of business, such as claims to enforce liens, claims involving the origination and servicing of loans, and other issues related to the business of Hanmi Financial and Hanmi Bank. In the opinion of management, the resolution of any such issues would not have a material adverse impact on the financial condition, results of operations, or liquidity of Hanmi Financial or Hanmi Bank.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS*

During the fourth quarter of 2006, no matters were submitted to stockholders for a vote.

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PART II

ITEM 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

Market Information

The following table sets forth, for the periods indicated, the high and low trading prices of Hanmi Financial s common stock for the last two years as reported by NASDAQ under the symbol HAFC.

	High	Low	Cash Dividend
2006:			
Fourth Quarter	$ 22.88	$ 18.89	$ 0.06 per share
Third Quarter	$ 20.00	$ 18.13	$ 0.06 per share
Second Quarter	$ 20.46	$ 17.09	$ 0.06 per share
First Quarter	$ 19.95	$ 17.04	$ 0.06 per share
2005:			
Fourth Quarter	$ 20.42	$ 16.51	$ 0.05 per share
Third Quarter	$ 19.72	$ 16.27	$ 0.05 per share
Second Quarter	$ 17.90	$ 14.05	$ 0.05 per share
First Quarter	$ 19.19	$ 15.62	$ 0.05 per share

Hanmi Financial had 344 registered stockholders of record as of February 14, 2007.

Dividends

The amount and timing of dividends will be determined by Hanmi Financial s Board of Directors and substantially depend upon the earnings and financial condition of Hanmi Financial. The ability of Hanmi Financial to obtain funds for the payment of dividends and for other cash requirements is largely dependent on the amount of dividends that may be declared by Hanmi Bank.

The power of the board of directors of a state chartered bank, such as Hanmi Bank, to declare a cash dividend is limited by statutory and regulatory restrictions that restrict the amount available for cash dividends depending upon the earnings, financial condition and cash needs of the bank, as well as general business conditions. See *Item 1. Business Dividends and Other Transfers of Funds.*

Securities Authorized for Issuance Under Equity Compensation Plans

The following table summarizes information as of December 31, 2006 relating to equity compensation plans of Hanmi Financial pursuant to which grants of options, restricted stock awards or other rights to acquire shares may be granted from time to time.

	Number of Securities Remaining Available for

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights *(a)*	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights *(b)*	Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column *(a)*)
Equity Compensation Plans Approved By Security Holders	1,755,813	$ 15.31	2,206,092
Equity Compensation Plans Not Approved By Security Holders	678,502[1]	$ 13.45	
Total Equity Compensation Plans	**2,434,315**	**$ 14.79**	**2,206,092**

[1] *Composed of: a) stock options granted to Chief Executive Officer to purchase 350,000 shares of common stock at an exercise price of $17.165 per share with vesting in equal annual installments of 16.66%, subject to accelerated vesting upon certain corporate transactions, and expiring no later than November 3, 2014; and b) remaining stock warrants issued to affiliates of Castle Creek Financial LLC (for services rendered in connection with the placement of Hanmi Financial s equity securities) to purchase a total of 328,502 shares of common stock at an exercise price of $9.50 per share.*

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Performance Graph

Set forth below is a graph comparing stockholder return on Hanmi Financial s common stock valued on the market price of common stock with the cumulative total returns for companies on an indexed basis of a $100 investment in Hanmi Financial common stock, the NASDAQ Composite® (U.S.) Index and the Standard and Poors (S&P) 500 Financials Index. The performance graph shall not be deemed incorporated by reference to any general statement incorporating by reference this Annual Report into any filing under the Security Act of 1933 or under the Exchange Act, except to the extent that we specifically incorporate this information by reference, and shall not otherwise be deemed filed under such Acts.

COMPARISON OF CUMULATIVE TOTAL RETURN ON $100 INVESTMENT AMONG HANMI FINANCIAL, NASDAQ COMPOSITE ® (U.S.) INDEX AND S&P 500 FINANCIALS INDEX COMPARATIVE RETURN

				December 31,			
Index	**Symbol**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Hanmi Financial	HAFC	100.00	125.24	148.62	270.18	268.53	338.74
NASDAQ Composite	^IXIC	100.00	68.47	102.71	111.53	113.06	123.82
S&P 500 Financials	S5FINL	100.00	83.58	106.92	115.72	120.03	139.43

ITEM 6. ***SELECTED FINANCIAL DATA***

The following table presents selected historical financial information, including per share information as adjusted for the stock dividends and stock splits declared by us. This selected historical financial data should be read in conjunction with our consolidated financial statements and the notes thereto appearing elsewhere in this Report and the information contained in *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.* The selected historical financial data as of and for each of the years in the five years ended December 31, 2006 is derived from our audited financial statements. In the opinion of management, the information

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presented reflects all adjustments, including normal and recurring accruals, considered necessary for a fair presentation of the results of such periods.

	As of and for the Year Ended December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands, except for per share data)				
SUMMARY STATEMENT OF INCOME:					
Interest Income	$ 260,189	$ 200,941	$ 135,554	$ 77,417	$ 69,316
Interest Expense	106,429	62,111	32,617	20,796	21,345
Net Interest Income Before Provision for Credit Losses	153,760	138,830	102,937	56,621	47,971
Provision for Credit Losses	7,173	5,395	2,907	5,680	4,800
Non-Interest Income	35,604	30,382	26,211	20,022	21,204
Non-Interest Expenses	75,954	69,133	66,566	39,325	38,333
Income Before Provision for Income Taxes	106,237	94,684	59,675	31,638	26,042
Provision for Income Taxes	40,588	36,455	22,975	12,425	9,012
NET INCOME	**$ 65,649**	**$ 58,229**	**$ 36,700**	**$ 19,213**	**$ 17,030**
SUMMARY STATEMENT OF FINANCIAL CONDITION:					
Cash and Cash Equivalents	$ 138,501	$ 163,477	$ 127,164	$ 62,595	$ 122,772
Total Investment Securities	391,579	443,912	418,973	414,616	279,548
Loans Receivable, Net(1)	2,837,390	2,469,080	2,234,842	1,248,399	975,154
Total Assets	3,725,243	3,414,252	3,104,188	1,787,139	1,457,313
Total Deposits	2,944,715	2,826,114	2,528,807	1,445,835	1,283,979
Total Liabilities	3,238,126	2,987,475	2,704,278	1,647,672	1,332,845
Total Shareholders Equity	487,117	426,777	399,910	139,467	124,468
Tangible Equity	273,159	209,028	178,791	137,424	122,304
Average Net Loans	2,721,229	2,359,439	1,912,534	1,103,765	882,625
Average Investment Securities	414,672	418,750	425,537	379,635	244,675
Average Interest-Earning Assets	3,214,761	2,871,564	2,387,412	1,538,820	1,222,050
Average Total Assets	3,602,181	3,249,190	2,670,701	1,623,214	1,308,885
Average Deposits	2,881,448	2,632,254	2,129,724	1,416,564	1,164,562
Average Borrowings	221,347	165,482	223,780	63,138	21,847
Average Interest-Bearing Liabilities	2,367,389	2,046,227	1,687,688	1,057,249	854,858
Average Shareholders Equity	458,227	417,813	293,313	132,369	112,927
Average Tangible Equity	242,362	198,527	143,262	130,252	110,762
PER SHARE DATA:					
Earnings Per Share Basic	$ 1.34	$ 1.18	$ 0.87	$ 0.68	$ 0.62

Earnings Per Share Diluted	$	1.33	$	1.17	$	0.84	$	0.67	$	0.60
Book Value Per Share[(2)]	$	9.93	$	8.77	$	8.11	$	4.92	$	4.47
Tangible Book Value Per Share[(3)]	$	5.57	$	4.30	$	3.62	$	4.85	$	4.39
Cash Dividends Per Share	$	0.24	$	0.20	$	0.20	$	0.20	$	
Common Shares Outstanding		49,076,613		48,658,798		49,330,704		28,326,820		27,830,866

(1) *Loans are net of deferred fees and related direct costs.*

(2) *Total shareholders equity divided by common shares outstanding.*

(3) *Tangible equity divided by common shares outstanding.*

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	As of and for the Year Ended December 31,				
	2006	2005	2004	2003	2002
SELECTED PERFORMANCE RATIOS:					
Return on Average Assets[4]	1.82%	1.79%	1.37%	1.18%	1.30%
Return on Average Shareholders Equity[5]	14.33%	13.94%	12.51%	14.51%	15.08%
Return on Average Tangible Equity[6]	27.09%	29.33%	25.62%	14.75%	15.38%
Net Interest Spread[7]	3.59%	3.96%	3.75%	3.06%	3.17%
Net Interest Margin[8]	4.78%	4.83%	4.31%	3.68%	3.93%
Efficiency Ratio[9]	40.11%	40.86%	51.54%	51.31%	55.41%
Dividend Payout Ratio[10]	17.91%	16.95%	22.99%	29.41%	
Average Shareholders Equity to Average Total Assets	12.72%	12.86%	10.98%	8.15%	8.63%
SELECTED CAPITAL RATIOS:					
Total Capital to Total Risk-Weighted Assets:					
Hanmi Financial	12.55%	12.04%	11.98%	11.13%	12.14%
Hanmi Bank	12.28%	11.98%	11.80%	11.09%	11.94%
Tier 1 Capital to Total Risk-Weighted Assets:					
Hanmi Financial	11.58%	11.03%	10.93%	10.05%	11.01%
Hanmi Bank	11.31%	10.96%	10.75%	10.00%	10.81%
Tier 1 Capital to Average Total Assets:					
Hanmi Financial	10.08%	9.11%	8.93%	7.80%	8.50%
Hanmi Bank	9.85%	9.06%	8.78%	7.75%	8.34%
SELECTED ASSET QUALITY RATIOS:					
Non-Performing Loans to Total Gross Loans[11]	0.50%	0.41%	0.27%	0.68%	0.65%
Non-Performing Assets to Total Assets[12]	0.38%	0.30%	0.19%	0.48%	0.44%
Net Loan Charge-Offs to Average Total Gross Loans	0.17%	0.12%	0.19%	0.29%	0.28%
Allowance for Loan Losses to Total Gross Loans	0.96%	1.00%	1.00%	1.06%	1.14%
Allowance for Loan Losses to Non-Performing Loans	193.86%	246.40%	377.49%	154.13%	173.81%

[4] *Net income divided by average total assets.*

[5] *Net income divided by average shareholders equity.*

[6] *Net income divided by average tangible equity.*

[7] *Average yield earned on interest-earning assets less average rate paid on interest-bearing liabilities.*

[8] *Net interest income before provision for credit losses divided by average interest-earning assets.*

[9] *Total non-interest expenses divided by the sum of net interest income before provision for credit losses and total non-interest income.*

(10) *Dividends declared per share divided by basic earnings per share.*

(11) *Non-performing loans consist of non-accrual loans, loans past due 90 days or more and restructured loans.*

(12) *Non-performing assets consist of non-performing loans and other real estate owned.*

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Non-GAAP Financial Measures

Return on Average Tangible Equity

Return on average tangible equity is supplemental financial information determined by a method other than in accordance with accounting principles generally accepted in the United States of America (GAAP). This non-GAAP measure is used by management in the analysis of Hanmi Financial s performance. Average tangible equity is calculated by subtracting average goodwill and average core deposit intangible assets from average shareholders equity. Banking and financial institution regulators also exclude goodwill and intangibles from shareholders equity when assessing the capital adequacy of a financial institution. Management believes the presentation of this financial measure excluding the impact of these items provides useful supplemental information that is essential to a proper understanding of the financial results of Hanmi Financial, as it provides a method to assess management s success in utilizing tangible capital. This disclosure should not be viewed as a substitution for results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies.

The following table reconciles this non-GAAP performance measure to the GAAP performance measure for the periods indicated:

	Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
	(Dollars in thousands)				
Average Shareholders Equity	$ 458,227	$ 417,813	$ 293,313	$ 132,369	$ 112,927
Less Average Goodwill and Core Deposit Intangible Assets	(215,865)	(219,286)	(150,051)	(2,117)	(2,165)
Average Tangible Equity	**$ 242,362**	**$ 198,527**	**$ 143,262**	**$ 130,252**	**$ 110,762**
Return on Average Shareholders Equity	14.33%	13.94%	12.51%	14.51%	15.08%
Effect of Average Goodwill and Core Deposit Intangible Assets	12.76%	15.39%	13.11%	0.24%	0.30%
Return on Average Tangible Equity	**27.09%**	**29.33%**	**25.62%**	**14.75%**	**15.38%**

Tangible Book Value Per Share

Tangible book value per share is supplemental financial information determined by a method other than in accordance with GAAP. This non-GAAP measure is used by management in the analysis of Hanmi Financial s performance. Tangible book value per share is calculated by subtracting goodwill and core deposit intangible assets from total shareholders equity and dividing the difference by the number of shares of common stock outstanding. Management believes the presentation of this financial measure excluding the impact of these items provides useful supplemental information that is essential to a proper understanding of the financial results of Hanmi Financial, as it provides a method to assess management s success in utilizing tangible capital. This disclosure should not be viewed as a substitution for results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies.

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The following table reconciles this non-GAAP performance measure to the GAAP performance measure for the periods indicated:

	December 31,				
	2006	2005	2004	2003	2002
	(Dollars in thousands, except per share amounts)				
Total Shareholders Equity	$ 487,117	$ 426,777	$ 399,910	$ 139,467	$ 124,468
Less Goodwill and Core Deposit Intangible Assets	(213,958)	(217,749)	(221,119)	(2,043)	(2,164)
Tangible Equity	**$ 273,159**	**$ 209,028**	**$ 178,791**	**$ 137,424**	**$ 122,304**
Book Value Per Share	$ 9.93	$ 8.77	$ 8.11	$ 4.92	$ 4.47
Effect of Goodwill and Core Deposit Intangible Assets	(4.36)	(4.47)	(4.49)	(0.07)	(0.08)
Tangible Book Value Per Share	**$ 5.57**	**$ 4.30**	**$ 3.62**	**$ 4.85**	**$ 4.39**

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

This discussion presents management s analysis of the financial condition and results of operations as of and for the years ended December 31, 2006, 2005 and 2004. This discussion should be read in conjunction with our consolidated financial statements and the notes related thereto presented elsewhere in this Report.

This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in such forward-looking statements because of certain factors discussed elsewhere in this report. See *Item 1A. Risk Factors.*

CRITICAL ACCOUNTING POLICIES

We have established various accounting policies that govern the application of accounting principles generally accepted in the United States of America in the preparation of our financial statements. Our significant accounting policies are described in the *Notes to Consolidated Financial Statements.* Certain accounting policies require us to make significant estimates and assumptions that have a material impact on the carrying value of certain assets and liabilities, and we consider these critical accounting policies. We use estimates and assumptions based on historical experience and other factors that we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods. Management has discussed the development and selection of these critical accounting policies with the Audit Committee of Hanmi Financial s Board of Directors.

Allowance for Loan Losses We believe the allowance for loan losses and allowance for off-balance sheet items are critical accounting policies that require significant estimates and assumptions that are particularly susceptible to significant change in the preparation of our financial statements. Our allowance for loan loss methodologies incorporate a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan loss that management believes is appropriate at each reporting date. Quantitative factors include our historical loss experiences on ten segmented loan pools by risk rating, delinquency and charge-off trends, collateral values, changes in non-performing loans, and other factors. Qualitative factors include the general economic environment in our markets, delinquency and charge-off trends, and the change in non-performing loans. Concentration of credit, change of lending management and staff, quality of loan review system, and change in interest rate are other qualitative factors that are considered in our methodologies. See *Financial Condition Allowance for Loan Losses and Allowance for Off-Balance Sheet Items,* *Results of Operations Provision for Credit Losses* and *Notes to Consolidated Financial Statements, Note 1 Summary of Significant Accounting Policies* for additional information on methodologies used to determine the allowance for loan losses and allowance for off-balance sheet items.

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Loan Sales We routinely sell SBA and residential mortgage loans to secondary market investors. When SBA guaranteed loans are sold, we generally retain the right to service these loans and we may retain residual and other interests, which are considered retained interests in the sold loans. The gain on sale recorded on these loans depends, in part, on our allocation of the previous carrying amount of the loans to the retained interests. Previous carrying amounts are allocated in proportion to the relative fair values of the loans sold and the interests retained. The fair values of retained interests are estimated based upon the present value of the associated expected future cash flows taking into consideration future prepayment rates, discount rates, expected credit losses and other factors that impact the value of the retained interests.

We may also record loan servicing assets when the benefits of servicing are expected to be more than adequate compensation to a servicer. We determine whether the benefits of servicing are expected to be more than adequate compensation to a servicer by discounting all of the future net cash flows associated with the contractual rights and obligations of the servicing agreement. The expected future net cash flows are discounted at a rate equal to the return that would adequately compensate a substitute servicer for performing the servicing. In addition to the anticipated rate of loan prepayments and discount rates, other assumptions (such as the cost to service the underlying loans, foreclosure costs, ancillary income and float rates) are also used in determining the value of the loan servicing assets. Loan servicing assets are discussed in more detail in *Notes to Consolidated Financial Statements, Note 1 Summary of Significant Accounting Policies* and *Note 6 Loan Servicing Asset* presented elsewhere herein.

OVERVIEW

Over the last two years, we have experienced significant growth in assets and deposits. During this same period, interest rates have increased, increasing our net interest margin, while competitive pricing pressures have depressed our net interest margin. Total assets increased to $3,725.2 million at December 31, 2006 from $3,414.3 million and $3,104.2 million at December 31, 2005 and 2004, respectively. Net loans increased to $2,837.4 million at December 31, 2006 from $2,469.1 million and $2,234.8 million at December 31, 2005 and 2004, respectively. Total deposits increased to $2,944.7 million at December 31, 2006 from $2,826.1 million and $2,528.8 million at December 31, 2005 and 2004, respectively.

On April 30, 2004, we completed the merger with PUB, which had assets of $1.2 billion. Therefore, operating results for the year ended December 31, 2004 include eight months of operations of the combined entity and the trends in earnings from 2004 to 2005 reflect an increase in average total assets from $2.67 billion for the year ended December 31, 2004 to $3.25 billion for the year ended December 31, 2005.

For the year ended December 31, 2006, net income was $65.6 million, representing an increase of $7.4 million, or 12.7 percent, from $58.2 million for the year ended December 31, 2005. This resulted in basic earnings per share of $1.34 and $1.18 for the years ended December 31, 2006 and 2005, respectively, and diluted earnings per share of $1.33 and $1.17 for the same years. Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities incurred to fund those assets. Net interest income is affected by changes in the volume of interest-earning assets and interest-bearing liabilities. It also is affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing liabilities. The increase in net income for 2006 was primarily attributable to an increase in average interest-earning assets. Net interest income increased by 10.8 percent from 2005 to 2006, which was primarily attributable to a 15.4 percent increase in the volume of average gross loans. At the same time, the average interest rate paid on interest-bearing liabilities increased by 146 basis points while the average interest rate earned on interest-earning assets increased by 109 basis points. As a result, the net interest spread decreased by 37 basis points from 3.96 percent in 2005 to 3.59 percent in 2006.

For the year ended December 31, 2005, net income was $58.2 million, representing an increase of $21.5 million, or 58.7 percent, from $36.7 million for the year ended December 31, 2004. This resulted in basic earnings per share of $1.18 and $0.87 for the years ended December 31, 2005 and 2004, respectively, and diluted earnings per share of $1.17 and $0.84 for the same years. The increase in net income for 2005 was attributable to increases in net interest margin and average interest-earning assets. Net interest income increased due to a 23.2 percent increase in the volume of average gross loans. The average interest rate paid on interest-bearing liabilities increased by 111 basis points while the average interest rate earned on interest-earning assets increased by 132 basis points. As a result, the net interest spread increased by 21 basis points from 3.75 percent in 2004 to 3.96 percent in 2005.

Our results of operations are significantly affected by the provision for credit losses. The provision for credit losses was $7.2 million, $5.4 million and $2.9 million in 2006, 2005 and 2004, respectively, reflecting changes in the balance and credit quality of the loan portfolio.

We also generated substantial non-interest income from service charges on deposit accounts, charges and fees from international trade finance, and gains on sales of loans. For the year ended December 31, 2006, non-interest income was $35.6 million, an increase of $5.2 million, or 17.2 percent, over 2005 non-interest income of $30.4 million. For the year ended December 31, 2005, non-interest income was $30.4 million, an increase of $4.2 million, or 15.9 percent, over 2004 non-interest income of $26.2 million.

Non-interest expenses consist primarily of employee compensation and benefits, occupancy and equipment expenses and data processing expenses. For the year ended December 31, 2006, non-interest expenses were $76.0 million, an increase of $6.8 million, or 9.9 percent, over 2005 non-interest expenses of $69.1 million. In 2006, the increase was primarily the result of higher compensation and an increase in total assets. Although non-interest expenses increased from the prior year, the efficiency ratio improved slightly to 40.11 percent compared to 40.86 percent in 2005. This improvement is attributable to greater operating efficiencies arising from economies of scale. For the year ended December 31, 2005, non-interest expenses were $69.1 million, an increase of $2.6 million, or 3.9 percent, over 2004 non-interest expenses of $66.6 million. This increase was primarily the result of the merger with PUB. The efficiency ratio improved to 40.86 percent in 2005 compared to 51.54 percent in 2004 as the Bank achieved greater operating efficiencies after completing the integration of PUB s operations into the Bank s, whereas 2004 non-interest expenses included the cost of parallel operations and non-recurring expenses associated with the merger.

RESULTS OF OPERATIONS

Net Interest Income, Net Interest Spread and Net Interest Margin

Our earnings depend largely upon the difference between the interest income received from our loan portfolio and other interest-earning assets and the interest paid on deposits and borrowings. The difference is net interest income. The difference between the yield earned on interest-earning assets and the cost of interest-bearing liabilities is net interest spread. Net interest income, when expressed as a percentage of average total interest-earning assets, is referred to as the net interest margin.

Net interest income is affected by the change in the level and mix of interest-earning assets and interest-bearing liabilities, referred to as volume changes. Our net interest income also is affected by changes in the yields earned on interest-earning assets and rates paid on interest-bearing liabilities, referred to as rate changes. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as Federal economic policies, the general supply of money in the economy, income tax policies, governmental budgetary matters and the actions of the FRB.

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The following table shows the average balances of assets, liabilities and shareholders equity; the amount of interest income and interest expense; the average yield or rate for each category of interest-earning assets and interest-bearing liabilities; and the net interest spread and the net interest margin for the periods indicated.

	Year Ended December 31,							
	2006			2005			2004	
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense
	(Dollars in thousands)							
rning Assets:								
s, Net[1]	$ 2,747,922	$ 239,075	8.70%	$ 2,382,230	$ 180,845	7.59%	$ 1,933,761	$ 117,999
Securities[2]	72,694	3,087	4.25%	74,166	3,122	4.21%	70,372	3,015
of Other nment Agencies	122,503	5,148	4.20%	102,703	4,002	3.90%	90,336	3,374
Securities	219,475	10,120	4.61%	241,881	10,271	4.25%	264,829	10,261
urities	24,684	1,354	5.49%	23,571	1,107	4.70%	15,041	716
nds Sold	27,410	1,402	5.11%	46,799	1,589	3.40%	12,772	183
ral Funds Sold	41	2	4.88%					
rning Deposits	32	1	4.04%	214	5	2.34%	301	6
st-Earning Assets	3,214,761	260,189	8.09%	2,871,564	200,941	7.00%	2,387,412	135,554
-Earning Assets:								
ash Equivalents	93,535			92,245			76,064	
for Loan Losses	(26,693)			(22,791)			(21,227)	
ts	320,578			308,172			228,452	
nterest-Earning	387,420			377,626			283,289	
ts	**$ 3,602,181**			**$ 3,249,190**			**$ 2,670,701**	
IES AND SHAREHOLDERS EQUITY								
aring Liabilities:								
	$ 107,811	1,853	1.72%	$ 138,167	2,130	1.54%	$ 131,589	1,790
rket Checking and ounts	471,780	14,539	3.08%	539,678	12,964	2.40%	466,880	8,098
sits of $100,000 or	1,286,202	64,184	4.99%	959,904	31,984	3.33%	611,555	10,966
Deposits	280,249	12,460	4.45%	242,996	7,114	2.93%	253,884	5,414
ances and Other s	138,941	6,977	5.02%	83,076	3,017	3.63%	141,374	3,305

ordinated Debentures	82,406	6,416	7.79%	82,406	4,902	5.95%	82,406	3,044
est-Bearing Liabilities	2,367,389	106,429	4.50%	2,046,227	62,111	3.04%	1,687,688	32,617
-Bearing Liabilities:								
eposits	735,406			751,509			665,816	
lities	41,159			33,641			23,884	
nterest-Bearing	776,565			785,150			689,700	
lities	3,143,954			2,831,377			2,377,388	
rs Equity	458,227			417,813			293,313	
ilities and ers Equity	**$ 3,602,181**			**$ 3,249,190**			**$ 2,670,701**	
st Income		**$ 153,760**			**$ 138,830**			**$ 102,937**
st Spread[3]			**3.59%**			**3.96%**		
st Margin[4]			**4.78%**			**4.83%**		

(1) *Loans are net of deferred fees and related direct costs. Loan fees have been included in the calculation of interest income. Loan fees were $4.8 million, $6.3 million and $6.2 million for the years ended December 31, 2006, 2005 and 2004, respectively.*

(2) *Tax-exempt income, computed on a tax-equivalent basis using an effective marginal rate of 35 percent, was $4.7 million, $4.8 million and $4.6 million for the years ended December 31, 2006, 2005 and 2004, respectively. Yields on tax-exempt income were 6.53 percent, 6.48 percent and 6.59 percent for the years ended December 31, 2006, 2005 and 2004, respectively.*

(3) *Represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.*

(4) *Represents net interest income as a percentage of average interest-earning assets.*

The following table sets forth, for the periods indicated, the dollar amount of changes in interest earned and paid for interest-earning assets and interest-bearing liabilities and the amount of change attributable to changes in average daily balances (volume) or changes in average daily interest rates (rate). The variances attributable to both the volume and rate changes have been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amount of the changes in each.

	Year Ended December 31,					
	2006 vs. 2005 Increase (Decrease) Due to Change in			2005 vs. 2004 Increase (Decrease) Due to Change in		
	Volume	**Rate**	**Total**	**Volume**	**Rate**	**Total**
	(In thousands)					
Interest Income:						
Gross Loans, Net	$ 29,839	$ 28,391	$ 58,230	$ 30,620	$ 32,226	$ 62,846
Municipal Securities	(63)	28	(35)	161	(54)	107
Obligations of Other U.S. Government Agencies	816	330	1,146	477	151	628
Other Debt Securities	(994)	843	(151)	(929)	939	10
Equity Securities	54	193	247	401	(10)	391
Federal Funds Sold	(807)	620	(187)	930	476	1,406
Term Federal Funds Sold	2		2			
Interest-Earning Deposits	(10)	6	(4)	(2)	1	(1)
Total Interest Income	28,837	30,411	59,248	31,658	33,729	65,387
Interest Expense:						
Savings	(503)	226	(277)	92	248	340
Money Market Checking and NOW Accounts	(1,773)	3,348	1,575	1,403	3,463	4,866
Time Deposits of $100,000 or More	13,068	19,132	32,200	8,385	12,633	21,018
Other Time Deposits	1,220	4,126	5,346	(241)	1,941	1,700
FHLB Advances and Other Borrowings	2,524	1,436	3,960	(1,685)	1,397	(288)
Junior Subordinated Debentures		1,514	1,514		1,858	1,858
Total Interest Expense	14,536	29,782	44,318	7,954	21,540	29,494
Change in Net Interest Income	**$ 14,301**	**$ 629**	**$ 14,930**	**$ 23,704**	**$ 12,189**	**$ 35,893**

For the years ended December 31, 2006 and 2005, net interest income was $153.8 million and $138.8 million, respectively. The net interest spread and net interest margin for the year ended December 31, 2006 were 3.59 percent and 4.78 percent, respectively, compared to 3.96 percent and 4.83 percent, respectively, for the year ended December 31, 2005.

For the years ended December 31, 2005 and 2004, net interest income was $138.8 million and $102.9 million, respectively. The net interest spread and net interest margin for the year ended December 31, 2005 were 3.96 percent and 4.83 percent, respectively, compared to 3.75 percent and 4.31 percent, respectively, for the year ended December 31, 2004.

Average interest-earning assets increased 12.0 percent to $3,214.8 million in 2006 from $2,871.6 million in 2005. Average gross loans increased 15.4 percent to $2,747.9 million in 2006 from $2,382.2 million in 2005, and average investment securities decreased 1.0 percent to $414.7 million in 2006 from $418.8 million in 2005. Total loan interest income increased by 32.2 percent in 2006 due to the increase in average gross loans outstanding and the increase in the average yield on loans from 7.59 percent in 2005 to 8.70 percent in 2006. The average interest rate charged on loans increased 111 basis points, reflecting the increase in the annual average WSJ Prime Rate of 182 basis points from 6.14 percent in 2005 to 7.96 percent in 2006. The yield on average interest-earning assets increased from 7.00 percent in 2005 to 8.09 percent in 2006, an increase of 109 basis points, reflecting a continued shift in the mix of average interest-earning assets from 83.0 percent loans, 14.6 percent securities and 2.4 percent other interest-earning assets in 2005 to 85.5 percent loans, 12.9 percent securities and 1.6 percent other interest-earning assets in 2006.

The majority of interest-earning assets growth in 2006 was funded by a $249.2 million, or 9.5 percent, increase in average total deposits. Total average interest-bearing liabilities grew by $321.2 million, or 15.7 percent to $2,367.4 million in 2006 compared to $2,046.2 million in 2005. The average interest rate paid for interest-bearing liabilities increased by 146 basis points from 3.04 percent in 2005 to 4.50 percent in 2006 due to competitive pricing. As a result of the increases in the yield on interest-earning assets and cost of interest-bearing liabilities, the net interest spread decreased to 3.59 percent in 2006 compared to 3.96 percent in 2005.

Short-term interest rates rose in the first half of 2006, as the FRB increased the targeted Federal funds rate from 4.25 percent as of December 31, 2005 to 5.25 percent by July 3, 2006, through a series of four 25 basis-point increases. During this period, long-term rates increased more slowly, with the yields on ten-year U.S. Treasury bonds increasing from 4.39 percent as of December 31, 2005 to a peak of 5.25 percent as of June 28, 2006, before decreasing again to 4.71 percent as of December 31, 2006, and the yield curve was inverted, that is, long-term rates exceeded short-term rates, for much of 2006. In this environment, and particularly in the first half of 2006, there was heavy demand among our customers for longer-term fixed-rate loans. This competitive environment placed pressure on loan portfolio yields, which flattened and, in the fourth quarter, declined slightly, as customers demanded more favorable pricing for both fixed-rate and floating-rate loans.

Interest rates on time deposits rose as customers, anticipating continued rate increases, demanded higher rates during the first half of the year. During this period, the Bank faced strong competitive pressures from established and newly organized banks serving its target market. During the second half of 2006, these competitive pressures lessened, as market participants made greater use of borrowings to control their costs of funds and customer expectations regarding continued rate increases changed. Nevertheless, the Bank s cost of time deposits continued to rise, as certificates of deposit, which have an average maturity of approximately five months, continued to re-price. The Bank was able to more effectively control its cost of savings, NOW and money market accounts, but experienced declines in their balances as customers shifted funds to higher-rate accounts.

Average interest-earning assets increased 20.3 percent to $2,871.6 million in 2005 from $2,387.4 million in 2004. Average gross loans increased 23.2 percent to $2,382.2 million in 2005 from $1,933.8 million in 2004, and average investment securities decreased 1.6 percent to $418.8 million in 2005 from $425.5 million in 2004. Total loan interest income increased by 53.3 percent in 2005 due to the increase in average gross loans outstanding and the increase in the average yield on loans from 6.10 percent in 2004 to 7.59 percent in 2005. The average interest rate charged on loans increased 149 basis points, reflecting the increase in the WSJ Prime Rate of 180 basis points from 4.34 percent in 2004 to 6.14 percent in 2005. The yield on average interest-earning assets increased from 5.68 percent in 2004 to 7.00 percent in 2005, an increase of 132 basis points, reflecting a shift in the mix of average interest-earning assets from 81.0 percent loans, 17.8 percent securities and 1.2 percent other interest-earning assets in 2004 to 83.0 percent loans, 14.6 percent securities and 2.4 percent other interest-earning assets in 2005.

The majority of interest-earning assets growth in 2005 was funded by a $502.5 million, or 23.6 percent, increase in average total deposits. Total average interest-bearing liabilities grew by 21.2 percent to $2,046.2 million in 2005 compared to $1,687.7 million in 2004. The average interest rate paid for interest-bearing liabilities increased by

111 basis points from 1.93 percent in 2004 to 3.04 percent in 2005 due to competitive pricing. As a result of the increases in the yield on interest-earning assets and cost of interest-bearing liabilities, the net interest spread increased to 3.96 percent in 2005 compared to 3.75 percent in 2004.

The 2005 net interest spread reflects the increase in the average balance of Federal funds sold, which are highly liquid but have a relatively low yield, from $12.8 million in 2004 to $46.8 million in 2005. The average yield on

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Federal funds sold was 3.40 percent and 1.43 percent in 2005 and 2004, respectively. In the second half of 2005, the Bank increased its rates on certificates of deposit to maintain relationships with valued customers and fund loan growth. In 2005, loan production increased 32.2 percent over 2004 levels. This trend was particularly evident in the second quarter of 2005 and continued throughout the second half of the year, during which production was 37.4 percent higher than 2004 levels. However, because of the flat yield curve (long-term interest rates were unusually low relative to short-term rates, approaching and briefly falling below short-term rates) and strong competition, the Bank experienced a high level of loan payoffs because management was unwilling to match the aggressive pricing on five- to seven-year fixed-rate loans offered to our customers by certain competitors.

Provision for Credit Losses

For the year ended December 31, 2006, the provision for credit losses was $7.2 million, compared to $5.4 million for the year ended December 31, 2005, an increase of 33.0 percent. The allowance for loan losses was 0.96 percent and 1.00 percent of total gross loans at December 31, 2006 and 2005, respectively, with the increase in the dollar amount allowed for credit losses due to an increase in loan volume. This was primarily due to the overall decrease in historical loss factors on pass grade loans, while non-performing assets increased from $10.1 million, or 0.41 percent of gross loans, as of December 31, 2005 to $14.2 million, or 0.50 percent of gross loans, as of December 31, 2006. The $368.3 million, or 14.9 percent, increase in the loan portfolio and the $4.1 million, or 40.3 percent, increase in non-performing assets required the provision to increase to $7.2 million in 2006 from $5.4 million in 2005 to maintain the necessary allowance level.

For the year ended December 31, 2005, the provision for credit losses was $5.4 million, compared to $2.9 million for the year ended December 31, 2004, an increase of 85.6 percent. The allowance for loan losses remained at 1.00 percent of total gross loans at December 31, 2005 and 2004, with the increase in the dollar amount allowed for credit losses due to an increase in loan volume. This was primarily due to the overall decrease in historical loss factors on pass grade loans, while non-performing assets increased from $6.1 million, or 0.27 percent of gross loans, as of December 31, 2004 to $10.1 million, or 0.41 percent of gross loans, as of December 31, 2005. The $235.2 million, or 10.4 percent, increase in the loan portfolio and the $4.1 million, or 68.5 percent, increase in non-performing assets required the provision to increase to $5.4 million in 2005 from $2.9 million in 2004 to maintain the necessary allowance level.

Non-Interest Income

The following table sets forth the various components of non-interest income for the years indicated:

	Year Ended December 31,		
	2006	**2005**	**2004**
		(In thousands)	
Service Charges on Deposit Accounts	$ 17,134	$ 15,782	$ 14,441
Trade Finance Fees	4,567	4,269	4,044
Remittance Fees	2,056	2,122	1,653
Other Service Charges and Fees	2,359	2,496	1,486
Bank-Owned Life Insurance Income	879	845	731
Increase in Fair Value of Derivatives	1,074	1,105	232
Other Income	616	625	493
Gain on Sales of Loans	6,917	3,021	2,997
Gain on Sales of Securities Available for Sale	2	117	134

Total Non-Interest Income	**$ 35,604**	**$ 30,382**	**$ 26,211**

We earn non-interest income from three major sources: service charges on deposit accounts, fees generated from international trade finance and gain on sales of loans. Non-interest income has become a significant part of revenue in the past several years. For the year ended December 31, 2006, non-interest income was $35.6 million, an increase of 17.2 percent from $30.4 million for the year ended December 31, 2005. The overall increase in non-interest income is primarily due to expansion in the Bank s loan and deposit portfolios.

Service charges on deposit accounts increased $1.4 million, or 8.6 percent, in 2006 compared to 2005 and increased $1.3 million, or 9.3 percent, in 2005 compared to 2004. Service charge income on deposit accounts increased in 2006 and 2005 due to an increase in the number of accounts and an increase in demand deposit transaction volume. Average demand deposits decreased by 2.1 percent to $735.4 million in 2006 from $751.5 million in 2005 and increased by 12.9 percent to $751.5 million in 2005 from $665.8 million in 2004. Service charges are constantly reviewed to maximize service charge income while still maintaining a competitive position.

Fees generated from international trade finance increased by 7.0 percent from $4.3 million in 2005 to $4.6 million in 2006 and increased 5.6 percent from $4.0 million in 2004 to $4.3 million in 2005. The increase was primarily due to the PUB merger. Trade finance fees relate primarily to import and export letters of credit.

Remittance fees decreased 3.1 percent and increased 28.4 percent in 2006 and 2005, respectively, to $2.1 million in 2006 from $2.1 million in 2005 and $1.7 million in 2004. The slight decrease in 2006 reflects slightly lower volumes compared to the prior year. The 2005 increase reflects increased volume derived from Hanmi Bank s close relationship with Korea Exchange Bank, a stockholder of Hanmi Financial.

The changes in the fair value of derivatives are caused primarily by movements in the indexes to which interest rates on certain certificates of deposit are tied. In 2005 and 2004, the Bank offered certificates of deposit tied to either the Standard & Poor s 500 Index or a basket of Asian currencies. As explained in *Notes to Consolidated Financial Statements, Note 16 Derivatives,* the Bank entered into swap transactions to hedge the market risk associated with such certificates of deposit. The swaps and the related derivatives embedded in the certificates of deposit are accounted for at fair value. The increases in the fair value of the swaps of $1.1 million, $1.1 million and $232,000 recorded in non-interest income in 2006, 2005 and 2004, respectively, are partially offset by changes in the fair value of the embedded derivatives recorded in non-interest expenses. See *Non-Interest Expenses.*

Gain on sales of loans was $6.9 million in 2006, compared to $3.0 million in each of 2005 and 2004, representing increases of 129.0 percent and 0.8 percent for the years ended December 31, 2006 and 2005, respectively. The increase in gain on sales of loans resulted from increased sales activity in SBA loans, which was primarily due to increased loan production and sales efforts, including the sale of some of the unguaranteed portions of SBA loans. The guaranteed portion of a substantial percentage of SBA loans is sold in the secondary markets, and servicing rights are retained. During 2006, there were $131.0 million of SBA loans sold, compared to $50.6 million in 2005 and $51.3 million in 2004. The lower premiums earned in 2005 reflect a greater use of brokers to refer loan applications, which causes a higher cost to originate loans, compared to retail originations through the branch network.

Non-Interest Expenses

The following table sets forth the breakdown of non-interest expenses for the years indicated:

	Year Ended December 31,		
	2006	**2005**	**2004**
		(In thousands)	
Salaries and Employee Benefits	$ 40,512	$ 36,839	$ 33,540
Occupancy and Equipment	10,130	8,978	8,098
Data Processing	4,939	4,844	4,540
Advertising and Promotion	2,997	2,913	3,001
Supplies and Communications	2,391	2,556	2,433

Professional Fees	1,910	2,201	2,068
Amortization of Core Deposit Intangible	2,379	2,785	1,872
Decrease in Fair Value of Embedded Option	582	748	
Other Operating Expenses	10,114	7,778	8,961
Merger-Related Expenses		(509)	2,053
Total Non-Interest Expenses	**$ 75,954**	**$ 69,133**	**$ 66,566**

For the year ended December 31, 2006, non-interest expenses were $76.0 million, an increase of $6.8 million, or 9.9 percent, from $69.1 million for the year ended December 31, 2005. For the year ended December 31, 2005, non-interest expenses were $69.1 million, an increase of $2.6 million, or 3.9 percent, from $66.6 million for the year ended December 31, 2004. The increase in 2006 was primarily the result of higher compensation and an increase in total assets. The increase in 2005 was primarily due to the PUB merger, which closed on April 30, 2004.

Salaries and employee benefits expenses for 2006 increased $3.7 million, or 10.0 percent, to $40.5 million from $36.8 million for 2005. Salaries and employee benefits expenses for 2005 increased $3.3 million, or 9.8 percent, to $36.8 million from $33.5 million for 2004. These increases were due primarily to annual salary increases, additional share-based compensation reflecting stock options granted and an increase in the average number of employees. Average headcount was 589, 535 and 503 in 2006, 2005 and 2004, respectively, representing increases of 10.1 percent, 6.4 percent and 36.5 percent, respectively, over the prior years. Assets per employee were $6.3 million at December 31, 2006, compared to $6.2 million and $5.8 million at December 31, 2005 and December 31, 2004, respectively, representing increases of 1.6 percent and 6.9 percent, respectively. The improvement in 2005 reflects the greater operating efficiencies achieved following the merger with PUB. The efficiencies were substantially achieved by March 2005.

Occupancy and equipment expenses for 2006 increased $1.1 million, or 12.8 percent, to $10.1 million from $9.0 million for 2005. Occupancy and equipment expenses for 2005 increased $880,000, or 10.9 percent, to $9.0 million compared to $8.1 million for 2004. The increase in 2006 was due to additional office space leased. The increase in 2005 was mainly due to the acquisition of 12 former PUB branches in April 2004, which increased the branch network to 27 facilities. Following the closure of four branches in October 2004 and an additional branch closure in January 2005, the Bank now operates 22 branches.

Data processing expense for 2006 increased $95,000, or 2.0 percent, to $4.9 million as a result of expenses associated with a 9.5 percent increase in average deposits and a 15.4 percent increase in average loans outstanding. Data processing expense for 2005 increased $304,000, or 6.7 percent, to $4.8 million from $4.5 million for 2004 as a result of a 28.5 percent increase in average deposits and a 23.2 percent increase in average loans outstanding. In 2004, additional expense was incurred because of the need to operate parallel systems until the conversion of the Bank s core data processing systems.

Professional fees were $1.9 million in 2006, representing a decrease of $291,000, or 13.2 percent, compared to $2.2 million in 2005. Professional fees were $2.2 million in 2005, representing an increase of $133,000, or 6.4 percent, compared to $2.1 million in 2004. The decrease in 2006 was caused primarily by higher regulatory compliance consulting fees in 2005.

Other operating expenses were $10.1 million for 2006, compared to $7.8 million for 2005, representing an increase of $2.3 million, or 30.0 percent. The increase is primarily attributable to a $534,000 operating loss related to an international trade transaction, amortization expense of $879,000 related to the termination in the fourth quarter of 2005 of interest rate swaps that had unrealized losses aggregating $2.1 million, and a $355,000 impairment charge to adjust the loan servicing asset to fair value. Other operating expenses were $7.8 million for 2005, compared to $9.0 million for 2004, representing a decrease of $1.2 million, or 13.2 percent. The decreases are primarily attributable to a $1.2 million decrease in loan referral fees from 2004 to 2005.

During the year ended December 31, 2004, restructuring charges totaling $2.1 million were recorded in connection with the acquisition of PUB, consisting of employee severance and retention bonuses, leasehold termination costs, and fixed asset impairment charges associated with planned branch closures. In 2004, $975,000 of restructuring costs was recognized related to retention bonuses paid to former PUB employees. Such costs are treated as period costs and are recognized in the period services are rendered. In 2005, $509,000 of restructuring charges was reversed, as severance payments were lower than anticipated.

Income Taxes

For the year ended December 31, 2006, income taxes of $40.6 million were recognized on pre-tax income of $106.2 million, representing an effective tax rate of 38.2 percent, compared to income taxes of $36.5 million recognized on pre-tax income of $94.7 million, representing an effective tax rate of 38.5 percent, for 2005, and

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income taxes of $23.0 million recognized on pre-tax income of $59.7 million, representing an effective tax rate of 38.5 percent, for 2004.

In addition, we have made investments in various tax credit funds totaling $6.5 million as of December 31, 2006 and recognized $659,000 of income tax credits earned from qualified low-income housing investments in 2006. We recognized an income tax credit of $673,000 for the tax year 2005 from $6.9 million in such investments. We intend to continue to make such investments as part of an effort to lower the effective tax rate and to meet our community reinvestment obligations under the CRA.

As indicated in *Notes to Consolidated Financial Statements, Note 11 Income Taxes,* income taxes are the sum of two components: current tax expense and deferred tax expense (benefit). Current tax expense is the result of applying the current tax rate to taxable income. The deferred portion is intended to account for the fact that income on which taxes are paid differs from financial statement pretax income because certain items of income and expense are recognized in different years for income tax purposes than in the financial statements. These differences in the years that income and expenses are recognized cause temporary differences.

Most of our temporary differences involve recognizing more expenses in our financial statements than we have been allowed to deduct for taxes, and therefore we normally have a net deferred tax asset. At December 31, 2006 and 2005, we had net deferred tax assets of $13.1 million and $9.7 million, respectively.

FINANCIAL CONDITION

Loan Portfolio

Total gross loans increased by $370.1 million, or 14.8 percent, in 2006. Total gross loans represented 77.0 percent of total assets at December 31, 2006 compared with 73.2 percent and 72.9 percent at December 31, 2005 and 2004, respectively.

Commercial and industrial loans were $1,726.4 million and $1,431.5 million at December 31, 2006 and 2005, respectively, representing 60.2 percent and 57.3 percent, respectively, of the total loan portfolio. Commercial loans include term loans and revolving lines of credit. Term loans typically have a maturity of three to five years and are extended to finance the purchase of business entities, owner-occupied commercial property, business equipment, leasehold improvements or for permanent working capital. SBA guaranteed loans usually have a longer maturity (five to twenty years). Lines of credit, in general, are extended on an annual basis to businesses that need temporary working capital and/or import/export financing. These borrowers are well diversified as to industry, location and their current and target markets. We manage the portfolio to avoid concentration in any of the areas mentioned.

Real estate loans were $1,041.4 million and $974.2 million at December 31, 2006 and 2005, respectively, representing 36.3 percent and 39.0 percent, respectively, of the total loan portfolio. Real estate loans are extended to finance the purchase and/or improvement of commercial real estate and residential property. The properties generally are investor-owned, but may be for user-owned purposes. Underwriting guidelines include, among other things, an appraisal in conformity with the USPAP, limitations on loan-to-value ratios, and minimum cash flow requirements to service debt. The majority of the properties taken as collateral are located in Southern California.

Overall, new loan production increased 7.6 percent in 2006 compared to 2005, as the Bank s customer base continued to expand and collateral values continued to increase, although at a slower pace than in past years. However, loan portfolio growth was restricted by a high level of loan payoffs caused by the flat or inverted yield curve that obtained throughout most of 2005 and 2006. In addition, aggressive pricing of five- to seven-year fixed-rate commercial real estate loans by certain competitors eroded the Bank s portfolio of commercial real estate loans tied to the prime rate.

The continued shift in the mix of the loan portfolio in 2005 and 2006 reflects management s intent to emphasize commercial and industrial lending, while continuing to grow the commercial real estate portfolio at a prudent pace commensurate with the Bank s rigorous underwriting standards and asset/liability management and profitability objectives.

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The following table sets forth the amount of total loans outstanding in each category as of the dates indicated:

	Amount of Loans Outstanding as of December 31,				
	2006	2005	2004	2003	2002
			(In thousands)		
Real Estate Loans:					
Commercial Property	$ 757,428	$ 733,650	$ 783,539	$ 397,853	$ 284,465
Construction	202,207	152,080	92,521	43,047	39,237
Residential Property[(1)]	81,758	88,442	80,786	58,477	47,891
Total Real Estate Loans	1,041,393	974,172	956,846	499,377	371,593
Commercial and Industrial Loans:					
Commercial Term Loans	1,202,612	945,210	754,108	433,398	346,522
Commercial Lines of Credit	225,630	224,271	201,940	120,856	117,304
SBA Loans[(2)]	171,631	155,491	166,285	91,717	66,443
International Loans	126,561	106,520	95,936	65,040	42,641
Total Commercial and Industrial Loans	1,726,434	1,431,492	1,218,269	711,011	572,910
Consumer Loans[(3)]	100,121	92,154	87,526	54,878	44,416
Total Gross Loans	**$ 2,867,948**	**$ 2,497,818**	**$ 2,262,641**	**$ 1,265,266**	**$ 988,919**

(1) *As of December 31, 2006 and 2005, loans held for sale totaling $630,000 and $1.1 million, respectively, were included at the lower of cost or fair value.*

(2) *As of December 31, 2006, 2005, 2004, 2003 and 2002, loans held for sale totaling $23.2 million, $0, $3.9 million, $25.5 million and $12.5 million, respectively, were included at the lower of cost or market.*

(3) *Consumer loans includes HELOCs.*

The following table sets forth the percentage distribution of loans in each category as of the dates indicated:

	Percentage Distribution of Loans as of December 31,				
	2006	2005	2004	2003	2002
Real Estate Loans:					
Commercial Property	26.4%	29.4%	34.6%	31.4%	28.8%
Construction	7.1%	6.1%	4.1%	3.4%	4.0%
Residential Property	2.8%	3.5%	3.6%	4.7%	4.8%

Total Real Estate Loans	36.3%	39.0%	42.3%	39.5%	37.6%
Commercial and Industrial Loans:					
Commercial Term Loans	41.9%	37.8%	33.3%	34.3%	35.0%
Commercial Lines of Credit	7.9%	9.0%	8.9%	9.6%	11.9%
SBA Loans	6.0%	6.2%	7.3%	7.2%	6.7%
International Loans	4.4%	4.3%	4.3%	5.1%	4.3%
Total Commercial and Industrial Loans	60.2%	57.3%	53.8%	56.2%	57.9%
Consumer Loans	3.5%	3.7%	3.9%	4.3%	4.5%
Total Gross Loans	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0**