EAST WEST BANCORP INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

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

For the quarterly period ended September 30, 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 000-24939

EAST WEST BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-4703316**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

135 N. Los Robles Ave, 7th Floor, Pasadena, California 91101
(Address of principal executive offices) (Zip Code)

(626) 768-6000
(Registrant s telephone number, including area code)

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 regis–trant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Large accelerated filer x 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 Exchange Act).
Yes o No x

Number of shares outstanding of the issuer s common stock on the latest practicable date: 61,240,103 shares of common stock as of October 31, 2006.

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1.	Condensed Consolidated Financial Statements (Unaudited)
	Notes to Condensed Consolidated Financial Statements (Unaudited)
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations
Item 3.	Quantitative and Qualitative Disclosures about Market Risk
Item 4.	Controls and Procedures

PART II - OTHER INFORMATION

Item 1.	Legal Proceedings
Item 1A.	Risk Factors
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds
Item 3.	Defaults upon Senior Securities
Item 4.	Submission of Matters to a Vote of Security Holders
Item 5.	Other Information
Item 6.	Exhibits

SIGNATURE

Forward-Looking Statements

Certain matters discussed in this report may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and as such, may involve risks and uncertainties. These forward-looking statements relate to, among other things, expectations of the environment in which the Company operates and projections of future performance including future earnings and financial condition. The Company s actual results, performance, or achievements may differ significantly from the results, performance, or achievements expected or implied in such forward-looking statements. For a discussion of some of the factors that might cause such differences, see the Company s Form 10-K under the heading Item 1A. Risk Factors. The Company does not undertake, and specifically disclaims any obligation to update any forward looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

3

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	September 30, 2006	**December 31, 2005**
ASSETS		
Cash and cash equivalents	$ 172,357	$ 151,192
Interest-bearing deposits in other banks	99	
Securities purchased under resale agreements	100,000	50,000
Investment securities available-for-sale, at fair value (with amortized cost of $1,502,710 in 2006 and $873,969 in 2005)	1,490,112	869,837
Loans receivable, net of allowance for loan losses of $79,096 in 2006 and $68,635 in 2005	8,363,680	6,724,320
Investment in Federal Home Loan Bank stock, at cost	75,647	45,707
Investment in Federal Reserve Bank stock, at cost	17,830	12,285
Other real estate owned, net	2,884	299
Investment in affordable housing partnerships	29,725	31,006
Premises and equipment, net	43,647	38,579
Due from customers on acceptances	10,886	6,074
Premiums on deposits acquired, net	22,193	18,853
Goodwill	244,176	143,254
Cash surrender value of life insurance policies	87,325	82,191
Accrued interest receivable and other assets	113,635	82,073
Deferred tax assets	38,106	22,586
TOTAL	**$ 10,812,302**	**$ 8,278,256**
LIABILITIES AND STOCKHOLDERS EQUITY		
Customer deposit accounts:		
Noninterest-bearing	$ 1,353,195	$ 1,331,992
Interest-bearing	5,746,481	4,926,595
Total deposits	7,099,676	6,258,587
Federal funds purchased	118,014	91,500
Federal Home Loan Bank advances	1,499,879	617,682
Securities sold under repurchase agreements	825,000	325,000
Notes payable	6,460	8,833
Bank acceptances outstanding	10,886	6,074
Accrued interest payable, accrued expenses and other liabilities	86,994	83,347
Long-term debt	184,023	153,095
Total liabilities	9,830,932	7,544,118
COMMITMENTS AND CONTINGENCIES (Note 7)		
STOCKHOLDERS EQUITY		
Common stock (par value of $0.001 per share) Authorized 200,000,000 shares Issued 66,144,383 shares in 2006 and 61,419,622 shares in 2005 Outstanding 61,206,684 shares in 2006 and 56,519,438 shares in 2005	66	61
Additional paid in capital	539,168	389,004
Retained earnings	489,197	393,846
Deferred compensation		(8,242)
Treasury stock, at cost 4,937,699 shares in 2006 and 4,900,184 shares in 2005	(39,181)	(37,905)
Accumulated other comprehensive loss, net of tax	(7,880)	(2,626)

Total stockholders equity	981,370	734,138
TOTAL	**$ 10,812,302**	**$ 8,278,256**

See accompanying notes to condensed consolidated financial statements.

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
INTEREST AND DIVIDEND INCOME				
Loans receivable, including fees	$ 156,333	$ 98,110	$ 425,630	$ 264,340
Investment securities available-for-sale	17,860	7,181	40,024	18,020
Securities purchased under resale agreements	1,917	224	5,160	224
Investment in Federal Home Loan Bank stock	844	568	2,052	1,705
Investment in Federal Reserve Bank stock	262	126	664	346
Short-term investments	96	78	332	177
Total interest and dividend income	177,312	106,287	473,862	284,812
INTEREST EXPENSE				
Customer deposit accounts	53,896	25,275	142,724	60,960
Federal Home Loan Bank advances	16,081	6,290	32,988	19,361
Securities sold under repurchase agreements	7,024	693	14,906	693
Long-term debt	3,432	1,810	9,346	4,295
Federal funds purchased	1,462	637	3,789	739
Total interest expense	81,895	34,705	203,753	86,048
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	95,417	71,582	270,109	198,764
PROVISION FOR LOAN LOSSES	3,500	4,500	8,166	13,370
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	91,917	67,082	261,943	185,394
NONINTEREST INCOME				
Branch fees	2,837	1,858	8,266	5,143
Letters of credit fees and commissions	2,065	2,029	6,396	6,533
Ancillary loan fees	925	645	2,835	1,774
Net gain on sales of investment securities available-for-sale	676	1,786	2,537	3,519
Income from life insurance policies	973	873	2,785	2,436
Income from secondary market activities	123	130	496	1,314
Net gain on sale of real estate owned			88	
Other operating income	504	506	1,673	1,572
Total noninterest income	8,103	7,827	25,076	22,291
NONINTEREST EXPENSE				
Compensation and employee benefits	18,589	12,979	50,589	38,318
Occupancy and equipment expense	5,610	3,736	15,726	10,426
Deposit-related expenses	2,365	2,326	7,020	6,088
Amortization of premiums on deposits acquired	1,691	782	5,308	1,988
Amortization of investments in affordable housing partnerships	1,555	1,581	4,281	4,971
Data processing	890	717	2,678	1,940
Deposit insurance premiums and regulatory assessments	339	258	1,021	709
Other operating expenses	10,907	7,927	30,646	21,985
Total noninterest expense	41,946	30,306	117,269	86,425
	58,074	44,603	169,750	121,260

INCOME BEFORE PROVISION FOR INCOME TAXES				
PROVISION FOR INCOME TAXES	22,512	16,020	65,492	43,695
NET INCOME	**$ 35,562**	**$ 28,583**	**$ 104,258**	**$ 77,565**
EARNINGS PER SHARE				
BASIC	$ 0.59	$ 0.54	$ 1.76	$ 1.47
DILUTED	$ 0.58	$ 0.52	$ 1.72	$ 1.43
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
BASIC	60,536	53,261	59,204	52,615
DILUTED	61,797	54,822	60,569	54,222

See accompanying notes to condensed consolidated financial statements.

5

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(In thousands, except share data)
(Unaudited)

	Common Stock	Additional Paid In Capital	Retained Earnings	Deferred Compensation	Treasury Stock	Accumulated Other Comprehensive Loss, Net of Tax	Comprehensive Income	Total Stockholders Equity
BALANCE, JANUARY 1, 2005	**$ 57**	**$ 260,152**	**$ 296,175**	**$ (5,422)**	**$ (36,649)**	**$ (4)**		**$ 514,309**
Comprehensive income								
Net income for the period			77,565				$ 77,565	77,565
Net unrealized loss on investment securities available-for-sale						(3,206)	(3,206)	(3,206)
Total comprehensive income							$ 74,359	
Stock compensation costs				2,092				2,092
Tax benefit from option exercises		1,497						1,497
Issuance of 461,625 shares pursuant to various stock plans and agreements	1	9,835		(4,150)				5,686
Issuance of 3,303 shares in lieu of Board of Director retainer fees		112						112
Cancellation of 29,966 shares due to forfeitures of issued restricted stock				957	(957)			
Issuance of 3,138,701 shares pursuant to United National Bank acquisition	3	106,713						106,716
Dividends paid on common stock			(7,896)					(7,896)
BALANCE, SEPTEMBER 30, 2005	**$ 61**	**$ 378,309**	**$ 365,844**	**$ (6,523)**	**$ (37,606)**	**$ (3,210)**		**$ 696,875**
BALANCE, JANUARY 1, 2006	**$ 61**	**$ 389,004**	**$ 393,846**	**$ (8,242)**	**$ (37,905)**	**$ (2,626)**		**$ 734,138**
Comprehensive income								
Net income for the period			104,258				$ 104,258	104,258
Net unrealized loss on investment securities available-for-sale						(5,254)	(5,254)	(5,254)
Total comprehensive income							$ 99,004	
Elimination of deferred compensation pursuant to adoption of SFAS No. 123(R)		(8,242)		8,242				
Stock compensation costs		4,216						4,216
Tax benefit from stock option exercises		9,896						9,896
Tax benefit from vested restricted stock		576						576
Issuance of 907,320 shares pursuant to various stock plans and agreements	1	8,441						8,442
Issuance of 3,895 shares pursuant to Director retainer Fee		156						156

Issuance of 3,647,440 shares pursuant to Standard Bank acquisition	4	133,845						133,849
Cancellation of 37,515 shares due to forfeitures of issued restricted stock		1,276			(1,276)			
Dividends paid on common stock			(8,907)					(8,907)
BALANCE, SEPTEMBER 30, 2006	**$ 66**	**$ 539,168**	**$ 489,197**	**$**	**$ (39,181)**	**$ (7,880)**		**$ 981,370**

	Nine Months Ended September 30,	
	2006	**2005**
	(In thousands)	
Disclosure of reclassification amounts:		
Unrealized holding loss on securities arising during the period, net of tax benefit of $2,739 in 2006 and $844 in 2005	$ (3,783)	$ (1,165)
Less: Reclassification adjustment for gain included in net income, net of tax expense of $1,066 in 2006 and $1,478 in 2005	(1,471)	(2,041)
Net unrealized loss on securities, net of tax benefit of $3,805 in 2006 and $2,322 in 2005	$ (5,254)	$ (3,206)

See accompanying notes to condensed consolidated financial statements.

6

EAST WEST BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 104,258	$ 77,565
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,938	7,128
Stock compensation costs	4,216	2,092
Deferred taxes	(15,354)	(4,370)
Provision for loan losses	8,166	13,370
Net gain on sales of investment securities, loans and other assets	(2,837)	(4,588)
Federal Home Loan Bank stock dividends	(1,910)	(1,537)
Originations of loans held for sale	(14,671)	(84,414)
Proceeds from sale of loans held for sale	14,697	85,385
Tax benefit from stock option exercises	(9,896)	1,497
Tax benefit from vested restricted stock	(576)	
Net change in accrued interest receivable and other assets	(30,139)	3,269
Net change in accrued interest payable, accrued expenses, and other liabilities	13,883	8,381
Total adjustments	(26,483)	26,213
Net cash provided by operating activities	77,775	103,778
CASH FLOWS FROM INVESTING ACTIVITIES		
Net loan originations	(1,498,479)	(935,658)
Purchases of:		
Securities purchased under resale agreement	(50,000)	(50,000)
Investment securities available-for-sale	(1,321,846)	(284,896)
Loans receivable		(1,988)
Federal Home Loan Bank stock	(40,707)	(13,440)
Federal Reserve Bank stock	(5,545)	(2,379)
Investments in affordable housing partnerships		(12)
Premises and equipment	(6,485)	(3,774)
Proceeds from unsettled securities acquired	225,616	
Proceeds from sale of:		
Investment securities available-for-sale	232,371	225,875
Loans receivable	5,070	
Premises and equipment	41	3
Other real estate owned	387	
Maturity of interest-bearing deposits in other banks	960	100
Repayments, maturity and redemption of investment securities available-for-sale	798,702	104,784
Redemption of Federal Home Loan Bank stock	19,816	15,228
Cash obtained from acquisitions, net of cash paid	98,351	49,077
Net cash used in investing activities	(1,541,748)	(897,080)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	112,095	742,542
Net increase in federal funds purchased	26,514	182,000
Net increase (decrease) in Federal Home Loan Bank Advances	812,000	(377,750)
Repayment of notes payable on affordable housing investments	(5,373)	(1,823)
Payment of debt issue cost		(80)
Proceeds from securities sold under repurchase agreements	500,000	200,000
Proceeds from issuance of long-term debt	30,000	95,000
Proceeds from common stock options exercised	5,539	1,903
Proceeds from stock warrants exercised	1,600	1,600
Proceeds from Employee Stock Purchase Plan	1,198	1,565
Tax benefit from stock option exercises	9,896	
Tax benefit from vested restricted stock	576	
Dividends paid on common stock	(8,907)	(7,896)
Net cash provided by financing activities	1,485,138	837,061

NET INCREASE IN CASH AND CASH EQUIVALENTS	21,165	43,759
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	151,192	93,075
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 172,357	$ 136,834
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 200,335	$ 81,350
Income tax payments, net of refunds	71,188	40,157
Noncash investing and financing activities:		
Guaranteed mortgage loan securitizations	334,495	117,305
Issuance of common stock pursuant to acquisition	133,849	106,716
Real estate investment financed through notes payable	3,000	
Real estate acquired through foreclosure	2,884	
Issuance of common stock to employees	105	618
Issuance of common stock in lieu of Board of Director retainer fees	156	112

See accompanying notes to condensed consolidated financial statements.

7

EAST WEST BANCORP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the Nine Months Ended September 30, 2006 and 2005
(Unaudited)

1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of East West Bancorp, Inc. (referred to herein on an unconsolidated basis as East West and on a consolidated basis as the Company) and its wholly owned subsidiaries, East West Bank and subsidiaries (the Bank) and East West Insurance Services, Inc. Intercompany transactions and accounts have been eliminated in consolidation. East West also has seven wholly-owned subsidiaries that are statutory business trusts (the Trusts). In accordance with Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities*, the Trusts are not consolidated into the accounts of East West Bancorp, Inc.

The interim consolidated financial statements, presented in accordance with accounting principles generally accepted in the United States of America (GAAP), are unaudited and reflect all adjustments which, in the opinion of management, are necessary for a fair statement of financial condition and results of operations for the interim periods. All adjustments are of a normal and recurring nature. Results for the nine months ended September 30, 2006 are not necessarily indicative of results that may be expected for any other interim period or for the year as a whole. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company s annual report on Form 10-K for the year ended December 31, 2005.

2. SIGNIFICANT ACCOUNTING POLICIES

Recent Accounting Standards

In December 2003, the Accounting Standards Executive Committee of the AICPA issued Statement of Position No. 03-3 (SOP 03-3), *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. SOP 03-3 addresses the accounting for differences between contractual cash flows and the cash flows expected to be collected from purchased loans or debt securities if those differences are attributable, in part, to credit quality. SOP 03-3 requires purchased loans and debt securities to be recorded initially at fair value based on the present value of the cash flows expected to be collected with no carryover of any valuation allowance previously recognized by the seller. Interest income should be recognized based on the effective yield from the cash flows expected to be collected. To the extent that the purchased loans or debt securities experience subsequent deterioration in credit quality, a valuation allowance would be established for any additional cash flows that are not expected to be received. However, if more cash flows subsequently are expected to be received than originally estimated, the effective yield would be adjusted on a prospective basis. SOP 03-3 is effective for loans and debt securities acquired by the Company after December 15, 2004. The adoption of this Statement on January 1, 2005 did not have a material impact on the Company s financial position, results of operations, or cash flows.

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment.* This Statement supersedes Accounting

Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance and is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation.* This Statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions.

This Statement requires a public entity to measure the cost of employee services received in exchange for award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award - the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The grant-date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for unique characteristics of those instruments (unless observable market prices for the same or similar instruments are available). If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification.

The Company adopted the revised accounting standards for stock based compensation effective January 1, 2006. SFAS No. 123(R) allows for two alternative transition methods. The Company follows the modified prospective method, which requires application of the new Statement to new awards and to awards modified, repurchased or cancelled after the required effective date. Accordingly, prior period amounts have not been restated. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of January 1, 2006 will be recognized as the requisite services are rendered on or after January 1, 2006. The compensation cost of that portion of awards is based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS No. 123. Under the transition provisions of SFAS No. 123(R), the Company has reduced additional paid in capital by $8.2 million, representing the remaining deferred compensation balance in the consolidated statement of changes in stockholders equity as of January 1, 2006.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which addresses accounting for changes in accounting principle, changes in accounting estimates, changes required by an accounting pronouncement in the instance that the pronouncement does not include specific transition provisions and error correction. SFAS No. 154 requires retrospective application to prior periods financial statements of changes in accounting principle and error correction unless impracticable to do so. SFAS No. 154 states an exception to retrospective application when a change in accounting principle, or the method of applying it, may be inseparable from the effect of a change in accounting estimate. When a change in principle is inseparable from a change in estimate, such as depreciation, amortization or depletion, the change to the financial statements is to be presented in a prospective manner. SFAS No. 154 and the required disclosures are effective for accounting changes and error corrections in fiscal years beginning after December 15, 2005.

In November 2005, the FASB issued Staff Position (FSP) Nos. FAS 115-1 and 124-1 to address the determination as to when an investment is considered impaired, whether that impairment is other than temporary and the measurement of an impairment loss. This FSP nullified certain requirements of Emerging Issues Task Force 03-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (EITF 03-1), and references existing other than temporary guidance. Furthermore, this FSP creates a three step process in determining when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The FSP is effective for reporting periods beginning

after December 15, 2005. The adoption of this FSP did not have a material impact on the Company s financial condition or results of operations.

During December 2005, the FASB issued FSP Statement of Position (SOP) 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*, which addresses the circumstances under which the terms of loan products give rise to such risk and the disclosures or other accounting considerations that apply for entities that originate, hold, guarantee, service, or invest in loan products with terms that may give rise to a concentration of credit risk. The guidance under this FSP is effective for interim and annual periods ending after December 19, 2005 and for loan products that are determined to represent a concentration of credit risk, disclosure requirements of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, should be provided for all periods presented. The adoption of this FSP did not have a significant impact on the Company s consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets*, which provides the following: 1) revised guidance on when a servicing asset and servicing liability should be recognized; 2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; 3) permits an entity to elect to measure servicing assets and servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period in which the changes occur; 4) upon initial adoption, permits a onetime reclassification of available-for-sale securities to trading securities for securities which are identified as offsetting the entity s exposure to changes in the fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value; and 5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional footnote disclosures. SFAS No. 156 is effective as of the beginning of an entity s first fiscal year that begins after September 15, 2006 with the effects of initial adoption being reported as a cumulative-effect adjustment to retained earnings. It is not anticipated that adoption will have a material impact on the Company s consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) which supplements SFAS No. 109, *Accounting for Income Taxes*, by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. The Interpretation requires that the tax effects of a position be recognized only if it is more-likely-than-not to be sustained based solely on its technical merits as of the reporting date. The more-likely-than-not threshold represents a positive assertion by management that a company is entitled to economic benefits of a tax position. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are to be recognized. Moreover, the more-likely-than-not threshold must continue to be met in each reporting period to support continued recognition of a benefit. At adoption, companies must adjust their financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any necessary adjustment would be recorded directly to retained earnings in the period of adoption and reported as a change in accounting principle. FIN 48 is effective for fiscal years beginning after December 15, 2006. It is not anticipated that adoption will have a material impact on the Company s financial condition, results of operations, or cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Quantifying Financial Misstatements*, which expresses the Staff s views regarding the process of quantifying financial statement misstatements. Registrants are required to quantify the impact of correcting all misstatements, including both the carryover and reversing effects of prior year misstatements, on the current year financial statements. The techniques most commonly used in practice to accumulate and quantify misstatements are generally referred to as the rollover (current year income statement perspective) and iron curtain (year-end balance perspective) approaches. The financial statements would require adjustment when either approach results in quantifying a

misstatement that is material, after considering all relevant quantitative and qualitative factors. Management does not expect this guidance to have a material effect on the Company s financial condition and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides a single definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles, expands required disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 12, 2007, and interim periods within those years. The provisions of SFAS No. 157 should be applied on a prospective basis. Management is assessing the potential impact of this guidance on the Company s financial condition and results of operations.

3. STOCK-BASED COMPENSATION

The Company issues stock options and restricted stock to employees under share-based compensation plans. As previously mentioned, the Company adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method. Under this method, the provisions of SFAS No. 123(R) are applied to new awards and to awards modified, repurchased or canceled after December 31, 2005 and to awards outstanding on December 31, 2005 for which requisite service has not yet been rendered. SFAS No. 123(R) requires companies to account for stock options using the fair value method, which generally results in compensation expense recognition. Prior to December 31, 2005, the Company accounted for its fixed stock options using the intrinsic-value method, as prescribed in APB Opinion No. 25. Accordingly, no stock option expense was recorded in periods prior to December 31, 2005.

The adoption of SFAS No. 123(R) resulted in incremental stock-based compensation expense during 2006. Since we have previously recognized compensation expense on restricted stock awards, the incremental stock-based compensation expense recognized pursuant to SFAS No. 123(R) relates only to issued and unvested stock option grants. The incremental stock-based compensation expense caused income before income taxes to decrease by $399 thousand and net income to decrease by $232 thousand for the quarter ended September 30, 2006. For the nine months ended September 30, 2006, incremental stock-based compensation expense reduced income before income taxes by $1.5 million and reduced net income by $853 thousand. This additional expense had no impact on basic and diluted earnings per share for the third quarter of 2006, but reduced both basic and diluted earnings per share by $0.01 for the nine months ended September 30, 2006. Cash provided by operating activities decreased by $10.5 million and cash provided by financing activities increased by an identical amount for the first nine months of 2006 related to excess tax benefits from stock-based payment arrangements.

Prior to the adoption of SFAS No. 123(R), the Company applied APB No. 25 to account for its stock based awards. The reported net income and earnings per share for the three and nine months ended September 30, 2005 have been presented below to reflect the impact had the Company been required to recognize compensation cost based on the fair value at the grant date for stock options as required under SFAS No. 123(R). The pro forma amounts are as follows (amounts are reflected in thousands, except per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net income, as reported	$ 28,583	$ 77,565
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	418	1,214
Deduct: Total stock-based employee compensation expense determined using fair value method, net of related tax effects	(1,051)	(2,411)
Net income, pro forma	$ 27,950	$ 76,368
Basic earnings per share		
As reported	$ 0.54	$ 1.47
Pro forma	$ 0.52	$ 1.45
Diluted earnings per share		
As reported	$ 0.52	$ 1.43
Pro forma	$ 0.51	$ 1.41

During the three and nine months ended September 30, 2006, total compensation cost recognized in the consolidated statements of income related to stock options and restricted stock awards amounted to $1.5 million and $4.2 million, respectively, with their related tax benefits of $632 thousand and $1.8 million, respectively.

During the three and nine months ended September 30, 2005, total compensation cost recognized in the consolidated statements of income related to restricted stock awards amounted to $721 thousand and $2.1 million, respectively, with their related tax benefits of $303 thousand and $879 thousand, respectively.

Stock Options

The Company issues fixed stock options to certain employees, officers, and directors. Stock options are issued at the current market price on the date of grant with a three-year or four-year vesting period and contractual terms of 7 or 10 years.

A summary of activity for the Company s stock options as of and for the nine months ended September 30, 2006 is presented below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (In thousands)
Outstanding at beginning of period	3,209,183	$ 13.51	
Granted	246,307	37.39	
Exercised	(750,343)	7.38	
Forfeited	(14,725)	26.78	
Outstanding at end of period	2,690,422	$ 17.33	$ 46,627
Options exercisable at September 30, 2006	2,159,175		$ 28,631
Weighted average fair value of options granted during the period	$ 10.12		

The weighted average grant-date fair value of options granted during the nine months ended September 30, 2006 and 2005 was $10.12 and $9.32, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Expected life (1)	4 years	3.5 years	4 years	3.5 years
Expected volatility (2)	26.5 %	28.3 %	27.7 %	28.1 %
Expected dividend yield	0.5 %	0.6 %	0.6 %	0.5 %
Risk-free interest rate (3)	4.6 %	4.1 %	4.7 %	4.0 %

(1) The expected life (estimated period of time outstanding) of stock options granted was estimated using the historical exercise behavior of employees.

(2) The expected volatility was based on historical volatility for a period equal to the stock option s expected life.

(3) The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes information about stock options outstanding as of September 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number of Exercisable Options	Weighted Average Exercise Price
$5.00 to $9.99	499,069	$ 5.64	2.2 years	499,069	$ 5.64
$10.00 to $14.99	656,725	12.60	5.0 years	656,725	12.60
$15.00 to $19.99	997,806	16.88	3.0 years	946,856	16.89
$25.00 to $29.99	114,475	26.61	4.4 years	51,025	26.63
$30.00 to $34.99	51,228	33.94	5.9 years	4,000	33.62
$35.00 to $39.99	352,374	37.32	6.1 years	1,250	35.14
$40.00 to $44.99	18,745	40.48	6.8 years	250	42.97
$5.00 to $44.99	2,690,422	$ 17.33	3.89 years	2,159,175	$ 13.26

During the three and nine months ended September 30, 2006 and 2005, activities related to stock options are presented as follows:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(In thousands)			
Total intrinsic value of options exercised	$ 7,025	$ 1,964	$ 23,542	$ 3,565
Total fair value of options vested	$ 935	$ 1,107	$ 1,806	$ 2,438

As of September 30, 2006, total unrecognized compensation cost related to stock options amounted to $3.6 million. This cost is expected to be recognized over a weighted average period of 3.5 years.

Restricted Stock

In addition to stock options, the Company also grants restricted stock awards to directors, certain officers and employees. The restricted shares awarded become fully vested after three to five years of continued employment from the date of grant. The Company becomes entitled to an income tax deduction in an amount equal to the taxable income reported by the holders of the restricted shares when the restrictions are released and the shares are issued. Restricted shares are forfeited if officers and employees terminate prior to the lapsing of restrictions. The Company records forfeitures of restricted stock as treasury share repurchases.

A summary of the activity for restricted stock as of September 30, 2006, including changes during the nine months then ended, is presented below:

	Shares	**Weighted Average Fair Value**
Outstanding at beginning of period	431,392	$ 30.60
Granted	166,106	36.77
Vested	(71,570)	18.24
Forfeited	(37,515)	33.72
Outstanding at end of period	488,413	$ 34.26

In March 2006, the Company also granted performance restricted stock with two-year cliff vesting to an executive officer. The number of shares that the executive will receive under this stock award will ultimately depend on the Company s achievement of specified performance targets. The performance period is January 1, 2006 through December 31, 2007. At the end of the performance period, the number of stock awards issued will be determined by adjusting upward or downward from the target amount of shares in a range between 24% and 124%. The final performance percentage on which the payout will be based, considering performance metrics established for the performance period, will be determined by the Board of Directors or a committee of the Board. If the Company performs below its performance targets, the Board or the committee may, at its discretion, choose not to award any shares. Shares of stock, if any, will be issued following the end of the performance period two years from the date of grant. Compensation costs are accrued over the service period

and are based on the probable outcome of the performance condition. The maximum number of shares subject to this grant cannot exceed 41,000 shares.

As of September 30, 2006, total unrecognized compensation cost related to restricted stock awards amounted to $10.3 million. This cost is expected to be recognized over a weighted average period of 3.2 years.

Employee Stock Purchase Plan

The Company adopted the 1998 Employee Stock Purchase Plan (the Purchase Plan) providing eligible employees of the Company and its subsidiaries participation in the ownership of the Company through the right to purchase shares of its common stock at a discount. Under the terms of the Purchase Plan, prior to April 2005, employees could purchase shares of the Company s common stock at the lesser of 85% of the per-share market price at the date of grant or exercise, subject to an annual limitation of common stock valued at $25,000. In April 2005, the terms of the Purchase Plan were amended to allow the employees to purchase shares at 90% of the per-share market price at the date of exercise, maintaining the annual common stock value limitation of $25,000. As of September 30, 2006, the Purchase Plan qualifies as a non-compensatory plan under Section 423 of the Internal Revenue Code and, accordingly, no compensation expense is recognized under the plan.

The Purchase Plan covers a total of 2,000,000 shares of the Company s common stock. During the nine months ended September 30, 2006, 34,319 shares totaling $1.2 million were sold to employees under the Purchase Plan.

4. BUSINESS COMBINATIONS

The Company has completed several business acquisitions that have all been accounted for using the purchase method of accounting. Accordingly all assets and liabilities were adjusted to and recorded at their estimated fair values as of the acquisition date. The excess of purchase price over fair value of net assets acquired, if identifiable, was recorded as a premium on purchased deposits, and if not identifiable, was recorded as goodwill. The estimated tax effect of differences between tax bases and market values has been reflected in deferred income taxes. The results of operations of the acquired entities have been included in the Company s consolidated financial statements from the date of acquisition.

At the close of business on March 17, 2006, the Company completed the acquisition of Standard Bank, a federal savings bank headquartered in Monterey Park, California. The purchase price was $200.3 million which was comprised of $66.4 million in cash and 3,647,440 shares of East West Bancorp, Inc. common stock. The Company recorded total goodwill of $100.8 million and core deposit premium of $8.6 million for this transaction.

The Company completed the acquisition of United National Bank, a commercial bank headquatered in San Marino, California, at the close of business on September 6, 2005. The purchase price was $177.9 million which was comprised of $71.1 million in cash and 3,138,701 shares of East West Bancorp, Inc. common stock. The Company recorded total goodwill of $99.6 million and core deposit premium of $15.0 million for this transaction.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition for these two transactions:

	Standard Bank (In thousands)	United National Bank
Cash and cash equivalents	$ 165,834	$ 120,221
Loans receivable	487,110	666,693
Premises and equipment	3,211	10,434
Core deposit premium	8,648	15,044
Goodwill	100,838	99,635
Other assets	239,585	146,966
Total assets acquired	1,005,226	1,058,993
Deposits	728,994	865,070
Other liabilities	75,960	16,063
Total liabilities assumed	804,954	881,133
Net assets acquired	$ 200,272	$ 177,860

The unaudited pro forma combined amounts presented below give effect to the acquisition of Standard Bank as if this transaction had been completed as of the beginning of each period. For the three and nine months ended September 30, 2005, the unaudited pro forma combined amounts also include the results of operations for United National Bank as if this transaction had been completed as of the beginning of each period. The unaudited pro forma information is not necessarily indicative of the results of operations that would have resulted had the acquisitions been completed at the beginning of the applicable period presented, nor is it necessarily indicative of the results of operations in future periods.

	Three Months Ended September 30, 2006 (1)	2005 (3)	Nine Months Ended September 30, 2006 (2)	2005 (3)
	(In thousands, except per share data)			
Net interest income	$ 95,417	$ 84,314	$ 274,213	$ 241,796
Provision for loan losses	(3,500)	(8,450)	(9,366)	(17,780)
Noninterest income	8,103	8,430	14,868	24,760
Noninterest expense	(41,946)	(37,385)	(119,497)	(107,572)
Income before provision for income taxes	58,074	46,909	160,218	141,204
Provision for income taxes	(22,512)	(17,331)	(61,484)	(52,189)
Net income	$ 35,562	$ 29,578	$ 98,734	$ 89,015
EARNINGS PER SHARE				
BASIC	$ 0.59	$ 0.50	$ 1.64	$ 1.51
DILUTED	$ 0.58	$ 0.49	$ 1.60	$ 1.47
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING				
BASIC	60,536	59,228	60,219	59,125
DILUTED	61,797	60,789	61,584	60,732

(1) Since the acquisition of Standard Bank was completed on March 17, 2006, there is no difference between the pro forma and actual results of operations for the three months ended September 30, 2006.

(2) The pro forma results of operations for the nine months ended September 30, 2006 includes $10.3 million in net realized losses on investment securities that were sold by Standard Bank during the first quarter of 2006. Further, the pro forma results of operations for the nine months ended September 30, 2006 reflect interest expense related to junior subordinated debt amounting to $30.0 million that was issued in connection with the acquisition of Standard Bank as if this debt instrument was issued at the beginning of the period.

(3) The pro forma results of operations for both periods in 2005 reflect additional interest expense related to $50.0 million in junior subordinated debt that was issued in connection with the acquisitions of United National Bank and Standard Bank as if these debt instruments were issued at the beginning of each period.

5. SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

During 2006, the Company has entered into three separate long-term transactions totaling $500.0 million involving the sale of securities under repurchase agreements. Repurchase agreements are accounted for as collateralized financing transactions and recorded at the amounts at which the securities were sold. The collateral for these agreements consist of U.S. Government agency and U.S. Government sponsored enterprise debt and mortgage-backed securities.

The first transaction, amounting to $200.0 million, has an effective date of April 25, 2006 and a maturity date of April 25, 2016. The interest rate is initially floating for the first two years from April 25, 2006 through April 25, 2008 based on the three-month Libor minus 125 basis points. Thereafter, the rate is fixed at 5.128% for the remainder of the term. As of September 30, 2006, the interest rate on this agreement is 4.235%. The counterparty has the right to call the transaction on April 25, 2008 and quarterly thereafter until maturity.

The second transaction, also amounting to $200.0 million, has an effective date of June 6, 2006 and a maturity date of June 6, 2013. The interest rate is initially floating for the first six months from June 6, 2006 through December 6, 2006 based on the three-month Libor minus 255 basis points. Thereafter, the rate is fixed at 5.00% for the remainder of the term. At September 30, 2006, the interest rate on this agreement is 2.84%. The counterparty has the right to call the transaction on December 6, 2006 and quarterly thereafter until maturity.

The third transaction, amounting to $100.0 million, has an effective date of September 7, 2006 and a maturity date of September 7, 2016. The interest rate is initially floating for the first nine months from September 7, 2006 through June 7, 2007 based on the three-month Libor minus 340 basis points. Thereafter, the rate is fixed at 4.7775% for the remainder of the term. At September 30, 2006, the interest rate on this agreement is 1.99%. The counterparty has the right to call the transaction on June 7, 2007 and quarterly thereafter until maturity.

In June 2006, the Company modified the terms of $50.0 million of its repurchase agreements in response to the increasing interest rate environment. This transaction was initially entered into by the Company in September 2005. Under the original terms of this seven-year agreement, the interest rate for the first year was based on the three-month Libor minus 100 basis points. Thereafter, the rate was fixed at 4.075% through the original maturity date of September 6, 2012. Under the modified terms, the interest rate on this agreement for the period from June 6, 2006 through December 6, 2006 is based on the three-month Libor minus 290 basis points. Thereafter, the rate is fixed at 5.00% through the extended maturity date of June 6, 2013. At September 30, 2006, the interest rate on this repurchase agreement is 2.49%. Under the terms of the modification, the counterparty has the right to call the transaction on December 6, 2006 and quarterly thereafter until maturity. The difference in the present value of the cash flows under the new terms of the debt instrument is less than 10% of the present value of the remaining cash flows under the original terms. As such, this modification of debt terms is not considered substantial, and therefore, does not constitute extinguishment of debt in accordance with the provisions of EITF 96-19, *Debtor s Accounting for a Modification or Exchange of Debt Instruments*. No gain or loss was recorded in the consolidated statements of income as a result of this debt modification.

6. JUNIOR SUBORDINATED DEBT

On March 15, 2006, the Company issued $30.9 million in junior subordinated debt securities through a pooled trust preferred offering. Similar to previous offerings, these securities were issued through a newly formed statutory business trust, East West Capital Trust VII (Trust VII), a wholly-owned subsidiary of the Company. The proceeds from the debt securities are loaned by Trust VII to the Company and are included in long-term debt in the accompanying Condensed Consolidated Balance Sheet. The securities issued by Trust VII have a scheduled maturity of June 15, 2036 and bear interest at a per annum rate based on the three-month Libor plus 135 basis points, payable on a quarterly basis. At September 30, 2006, the interest rate on the junior subordinated debt was 6.74%. The junior subordinated debt issued qualifies as Tier I capital for regulatory reporting purposes.

7. COMMITMENTS AND CONTINGENCIES

Credit Extensions - In the normal course of business, the Company has various outstanding commitments to extend credit that are not reflected in the accompanying interim consolidated financial statements. As of September 30, 2006, undisbursed loan commitments and commercial and standby letters of credit amounted to $2.25 billion and $449.0 million, respectively.

18

Guarantees From time to time, the Company sells loans with recourse in the ordinary course of business. For loans that have been sold with recourse, the recourse component is considered a guarantee. When the Company sells a loan with recourse, it commits to stand ready to perform if the loan defaults, and to make payments to remedy the default. As of September 30, 2006 and December 31, 2005, loans sold with recourse, comprised entirely of residential single family mortgage loans, totaled $27.9 million and $31.6 million, respectively. The Company s recourse reserve related to these loans totaled $61 thousand and $76 thousand as of September 30, 2006 and December 31, 2005, respectively, and is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

The Company also sells loans without recourse that may have to be subsequently repurchased if a defect that occurred during the loan origination process results in a violation of a representation or warranty made in connection with the sale of the loan. When a loan sold to an investor without recourse fails to perform according to its contractual terms, the investor will typically review the loan file to determine whether defects in the origination process occurred and if such defects give rise to a violation of a representation or warranty made to the investor in connection with the sale. If such a defect is identified, the Company may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no such defects, the Company has no commitment to repurchase the loan. As of September 30, 2006 and December 31, 2005, the amount of loans sold without recourse totaled $1.05 billion and $777.6 million, which substantially represents the unpaid principal balance of the Company s loans serviced for others portfolio.

Litigation - Neither the Company nor the Bank is involved in any material legal proceedings at September 30, 2006. The Bank, from time to time, is a party to litigation which 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 the Bank. After taking into consideration information furnished by counsel to the Company and the Bank, management believes that the resolution of such issues will not have a material adverse impact on the financial position, results of operations, or liquidity of the Company or the Bank.

Regulated Investment Company On December 31, 2003**, the California Franchise Tax Board (FTB) announced that it is taking the position that certain tax deductions relating to regulated investment companies will be disallowed pursuant to California Senate Bill 614 and California Assembly Bill 1601, which were signed into law in the fourth quarter of 2003.** East West Securities Company, Inc. (the Fund), a regulated investment company (RIC) formed and funded in July 2000 to raise capital in an efficient and economical manner was dissolved on December 30, 2002 as a result of, among other reasons, proposed legislation to change the tax treatments of RICs. The Fund provided state tax benefits beginning in 2000 until the end of 2002, when the RIC was officially dissolved. While the Company s management continues to believe that the tax benefits realized in previous years were appropriate and fully defensible under the existing tax codes at that time, the Company has deemed it prudent to participate in the voluntary compliance initiative, or VCI offered by the State of California to avoid certain potential penalties should the FTB choose to litigate its announced position about the tax treatment of RICs for periods prior to enactment of the legislation described above and should the FTB be successful in that litigation.

Pursuant to the VCI program, the Company filed amended California income tax returns on April 15, 2004 for all affected years and paid the resulting taxes and interest due to the FTB. This amounted to an aggregate payment of $14.2 million for tax years 2000, 2001, and 2002. The Company s management continues to believe that the tax deductions are appropriate and, as such, refund claims have also been filed for the amounts paid with the amended returns. These refund claims are reflected as assets in the Company s consolidated financial statements. As a result of these actions amending the Company s California income tax returns and subsequent related filing of refund claims the Company retains its potential exposure for assertion of an accuracy-related penalty should the FTB prevail in its position, in addition to our risk of not being

successful in our refund claim for taxes and interest. The Company s potential exposure to all other penalties, however, has been eliminated through this course of action.

The FTB is currently in the process of reviewing and assessing our refund claims for taxes and interest for tax years 2000 through 2002. Management is continuing to pursue these claims, to monitor developments in the law in this area, and to monitor the status of tax claims with respect to other registered investment companies.

8. STOCKHOLDERS EQUITY

Earnings Per Share - The actual number of shares outstanding at September 30, 2006 was 61,206,684. Basic earnings per share are calculated on the basis of the weighted average number of shares outstanding during the period. Diluted earnings per share are calculated on the basis of the weighted average number of shares outstanding during the period plus restricted stock and shares issuable upon the assumed exercise of outstanding common stock options and warrants.

The following table sets forth earnings per share calculations for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,					
	2006			**2005**		
	Net Income	**Number of Shares**	**Per Share Amounts**	**Net Income**	**Number of Shares**	**Per Share Amounts**
	(In thousands, except per share data)					
Basic earnings per share	$ 35,562	60,536	$ 0.59	$ 28,583	53,261	$ 0.54
Effect of dilutive securities:						
Stock options		995	(0.01)		1,312	(0.02)
Restricted stock		190			135	
Stock warrants		76			114	
Dilutive earnings per share	$ 35,562	61,797	$ 0.58	$ 28,583	54,822	$ 0.52

	Nine Months Ended September 30,					
	2006			**2005**		
	Net Income	**Number of Shares**	**Per Share Amounts**	**Net Income**	**Number of Shares**	**Per Share Amounts**
	(In thousands, except per share data)					
Basic earnings per share	$ 104,258	59,204	$ 1.76	$ 77,565	52,615	$ 1.47
Effect of dilutive securities:						
Stock options		1,098	(0.04)		1,346	(0.04)
Restricted stock		182			136	
Stock warrants		85			125	
Dilutive earnings per share	$ 104,258	60,569	$ 1.72	$ 77,565	54,222	$ 1.43

Quarterly Dividends The Company s Board of Directors declared and paid quarterly common stock cash dividends of $0.05 per share which was paid on August 23, 2006 to shareholders of record on August 9, 2006. Cash dividends totaling $3.0 million were paid to the Company s shareholders during the third quarter of 2006.

9. BUSINESS SEGMENTS

The Company utilizes an internal reporting system to measure the performance of various operating segments within the Bank and the Company overall. The Company has identified four principal operating segments for purposes of management reporting: retail banking, commercial lending, treasury, and residential lending. Information related to the Company s remaining centralized functions and eliminations of inter-segment amounts have been aggregated and included in Other. Although all four operating segments offer financial products and services, they are managed separately based on each segment s strategic focus. While the retail banking segment focuses primarily on retail operations through the Bank s branch network, certain designated branches have responsibility for generating commercial deposits and loans. The commercial lending segment, which includes commercial real estate, primarily generates commercial loans and deposits through the efforts of commercial lending officers located in the Bank s northern and southern California production offices. The treasury department s primary focus is managing the Bank s investments, liquidity, and interest rate risk; the residential lending segment is mainly responsible for the Bank s portfolio of single family and multifamily residential loans.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies described in Note 1 of our annual report on Form 10-K for the year ended December 31, 2005. Operating segment results are based on the Company s internal management reporting process, which reflects assignments and allocations of capital, certain operating and administrative costs and the provision for loan losses. Net interest income is based on the Company s internal funds transfer pricing system which assigns a cost of funds or a credit for funds to assets or liabilities based on their type, maturity or re-pricing characteristics. Noninterest income and noninterest expense, including depreciation and amortization, directly attributable to a segment are assigned to that business. Indirect costs, including overhead expense, are allocated to the segments based on several factors, including, but not limited to, full-time equivalent employees, loan volume and deposit volume. The provision for credit losses is allocated based on actual losses incurred and an allocation of the remaining provision based on new loan originations for the period. The Company evaluates overall performance based on profit or loss from operations before income taxes not including nonrecurring gains and losses.

Future changes in the Company s management structure or reporting methodologies may result in changes in the measurement of operating segment results. Results for prior periods have been restated for comparability for changes in management structure or reporting methodologies. Specifically, an adjustment was made to reallocate the credit provided for the Company s capital to the treasury segment from the Other category. The adjustment resulted in an increase in the treasury segment s pretax profit of $6.6 million and $1.9 million for the three months ended September 30, 2006 and 2005, respectively. For the nine months ended September 30, 2006 and 2005, this adjustment resulted in an increase in the treasury segment s pretax profit of $18.7 million and $11.7 million, respectively.

The following tables present the operating results and other key financial measures for the individual operating segments for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30, 2006					
	Retail Banking (In thousands)	Commercial Lending	Treasury	Residential Lending	Other	Total
Interest income	$ 61,692	$ 73,564	$ 20,980	$ 19,462	$ 1,614	$ 177,312
Charge for funds used	(44,467)	(51,125)	(21,974)	(15,868)		(133,434)
Interest spread on funds used	17,225	22,439	(994)	3,594	1,614	43,878
Interest expense	(37,779)	(5,837)	(35,412)		(2,867)	(81,895)
Credit on funds provided	72,083	10,699	50,652			133,434
Interest spread on funds provided	34,304	4,862	15,240		(2,867)	51,539
Net interest income	$ 51,529	$ 27,301	$ 14,246	$ 3,594	$ (1,253)	$ 95,417
Depreciation and amortization	$ 2,596	$ 174	$ (1,228)	$ (76)	$ 752	$ 2,218
Goodwill	182,488	12,166		48,663	859	244,176
Segment pretax profit (loss)	28,997	22,232	11,484	1,806	(6,445)	58,074
Segment assets	2,468,924	3,421,399	1,611,488	2,609,012	701,479	10,812,302

	Three Months Ended September 30, 2005					
	Retail Banking (In thousands)	Commercial Lending	Treasury	Residential Lending	Other	Total
Interest income	$ 35,116	$ 47,619	$ 8,176	$ 14,153	$ 1,223	$ 106,287
Charge for funds used	(20,913)	(27,429)	(8,648)	(9,012)		(66,002)
Interest spread on funds used	14,203	20,190	(472)	5,141	1,223	40,285
Interest expense	(16,498)	(2,366)	(15,841)			(34,705)
Credit on funds provided	38,556	5,482	21,964			66,002
Interest spread on funds provided	22,058	3,116	6,123			31,297
Net interest income	$ 36,261	$ 23,306	$ 5,651	$ 5,141	$ 1,223	$ 71,582
Depreciation and amortization	$ 1,457	$ 119	$ (458)	$ 239	$ 967	$ 2,324
Goodwill	107,649	7,177		28,706	958	144,490
Segment pretax profit (loss)	16,729	19,699	6,956	3,076	(1,857)	44,603
Segment assets	1,711,258	2,401,139	833,954	2,555,291	436,736	7,938,378

Nine Months Ended September 30, 2006