CATHAY GENERAL BANCORP
Form 10-Q
November 10, 2008

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, 2008

OR

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

For the transition period from to

Commission file number 0-18630

CATHAY GENERAL BANCORP
(Exact name of registrant as specified in its charter)

Delaware (State of other jurisdiction of incorporation or organization)	95-4274680 (I.R.S. Employer Identification No.)
777 North Broadway, Los Angeles, California (Address of principal executive offices)	90012 (Zip Code)

Registrant's telephone number, including area code: (213) 625-4700

(Former name, former address and former fiscal year, if changed since last report)

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

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

Large accelerated filer R		Accelerated filer ¨
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, $.01 par value, 49,506,699 shares outstanding as of October 31, 2008.

CATHAY GENERAL BANCORP AND SUBSIDIARIES
3RD QUARTER 2008 REPORT ON FORM 10-Q
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Forward-Looking Statements

In this quarterly Report on Form 10-Q, the term "Bancorp" refers to Cathay General Bancorp and the term "Bank" refers to Cathay Bank. The terms "Company," "we," "us," and "our" refer to Bancorp and the Bank collectively. The statements in this report include forward-looking statements within the meaning of the applicable provisions of the Private Securities Litigation Reform Act of 1995 regarding management's beliefs, projections, and assumptions concerning future results and events. These forward-looking statements may include, but are not limited to, such words as "believes," "expects," "anticipates," "intends," "plans," "estimates," "may," "will," "should," "could," "predicts," "potential," "continue," or the negative of such terms and other comparable terminology or similar expressions. Forward-looking statements are not guarantees. They involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such risks and uncertainties and other factors include, but are not limited to adverse developments or conditions related to or arising from:

- significant volatility and deterioration in the credit and financial markets and adverse changes in economic conditions resulting from a prolonged economic downturn;
- successful consummation of the purchase of preferred securities by the U.S. Treasury pursuant to its Capital Purchase Program;
- the impact of any goodwill impairment that may be determined;
- deterioration in asset or credit quality;
- acquisitions of other banks, if any;
- fluctuations in interest rates;
- expansion into new market areas;
- earthquake, wildfire or other natural disasters;
- competitive pressures;
- legislative and regulatory developments; and
- general economic or business conditions in California and other regions where the Bank has operations.

These and other factors are further described in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, (at Item 1A in particular) its reports and registration statements filed with the Securities and Exchange Commission ("SEC") and other filings it makes in the future with the SEC from time to time. Actual results in any future period may also vary from the past results discussed in this report. Given these risks and uncertainties, we caution readers not to place undue reliance on any forward-looking statements, which speak to the date of this report. The Company has no intention and undertakes no obligation to update any forward-looking statement or to publicly announce the results of any revision of any forward-looking statement to reflect future developments or events.

The Company's filings with the SEC are available to the public at the website maintained by the SEC at *http://www.sec.gov*, or by requests directed to Cathay General Bancorp, 777 North Broadway, Los Angeles, California 90012, Attn: Investor Relations (213) 625-4749.

PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS (Unaudited)

CATHAY GENERAL BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2008	December 31, 2007	% change
	(In thousands, except share and per share data)		
Assets			
Cash and due from banks	$ 82,923	$ 118,437	(30)
Short-term investments	5,185	2,278	128
Securities purchased under agreements to resell	150,000	516,100	(71)
Long-term certificates of deposit	-	50,000	(100)
Securities available-for-sale (amortized cost of $2,619,804 in 2008 and $2,348,606 in 2007)	2,592,331	2,347,665	10
Trading securities	19	5,225	(100)
Loans	7,499,281	6,683,645	12
Less: Allowance for loan losses	(92,068)	(64,983)	42
Unamortized deferred loan fees, net	(10,290)	(10,583)	(3)
Loans, net	7,396,923	6,608,079	12
Federal Home Loan Bank stock	67,672	65,720	3
Other real estate owned, net	43,410	16,147	169
Affordable housing investments, net	105,748	94,000	12
Premises and equipment, net	98,182	76,848	28
Customers' liability on acceptances	52,460	53,148	(1)
Accrued interest receivable	41,394	53,032	(22)
Goodwill	319,557	319,873	(0)
Other intangible assets, net	30,945	36,097	(14)
Other assets	68,573	39,883	72
Total assets	$ 11,055,322	$ 10,402,532	6
Liabilities and Stockholders' Equity			
Deposits			
Non-interest-bearing demand deposits	$ 821,233	$ 785,364	5
Interest-bearing deposits:			
NOW deposits	270,763	231,583	17
Money market deposits	785,119	681,783	15
Savings deposits	340,316	331,316	3
Time deposits under $100,000	1,550,433	1,311,251	18
Time deposits of $100,000 or more	3,081,306	2,937,070	5
Total deposits	6,849,170	6,278,367	9
Federal funds purchased	33,000	41,000	(20)
Securities sold under agreements to repurchase	1,550,000	1,391,025	11
Advances from the Federal Home Loan Bank	1,276,713	1,375,180	(7)
Other borrowings from financial institutions	-	8,301	(100)
Other borrowings for affordable housing investments	19,541	19,642	(1)

Long-term debt		171,136		171,136	-
Acceptances outstanding		52,460		53,148	(1)
Minority interest in consolidated subsidiary		8,500		8,500	-
Other liabilities		92,649		84,314	10
Total liabilities		10,053,169		9,430,613	7
Commitments and contingencies		-		-	-
Stockholders' Equity					
Preferred stock, $0.01 par value; 10,000,000 shares authorized, none issued		-		-	-
Common stock, $0.01 par value, 100,000,000 shares authorized, 53,685,271 issued and 49,477,706 outstanding at September 30, 2008 and 53,543,752 issued and 49,336,187 outstanding at December 31, 2007		537		535	0
Additional paid-in-capital		488,446		480,557	2
Accumulated other comprehensive loss, net		(15,921)		(545)	2,821
Retained earnings		654,827		617,108	6
Treasury stock, at cost (4,207,565 shares at September 30, 2008 and at December 31, 2007)		(125,736)		(125,736)	-
Total stockholders' equity		1,002,153		971,919	3
Total liabilities and stockholders' equity	$	11,055,322	$	10,402,532	6

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CATHAY GENERAL BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
	(In thousands, except share and per share data)			
INTEREST AND DIVIDEND INCOME				
Loan receivable, including loan fees	$ 114,005	$ 123,925	$ 341,880	$ 356,841
Investment securities- taxable	27,575	25,127	84,507	71,381
Investment securities- nontaxable	284	443	974	1,625
Federal Home Loan Bank stock	1,004	639	2,685	1,689
Agency preferred stock	313	174	1,621	512
Federal funds sold and securities purchased under agreements to resell	2,899	7,615	12,294	15,382
Deposits with banks	42	1,248	523	3,288
Total interest and dividend income	146,122	159,171	444,484	450,718
INTEREST EXPENSE				
Time deposits of $100,000 or more	26,226	34,475	86,398	97,527
Other deposits	17,100	20,068	49,519	56,739
Securities sold under agreements to repurchase	15,174	9,865	44,716	23,126
Advances from Federal Home Loan Bank	11,785	11,472	35,229	34,930
Long-term debt	2,030	3,182	6,889	8,057
Short-term borrowings	206	282	828	1,263
Total interest expense	72,521	79,344	223,579	221,642
Net interest income before provision for credit losses	73,601	79,827	220,905	229,076
Provision for credit losses	15,800	2,200	43,800	5,300
Net interest income after provision for credit losses	57,801	77,627	177,105	223,776
NON-INTEREST INCOME				
Securities (losses)/gains, net	(15,313)	88	(12,980)	268
Letters of credit commissions	1,465	1,622	4,281	4,349
Depository service fees	1,189	1,146	3,636	3,529
Gains from sale of premises and equipment	-	2,705	21	2,714
Other operating income	4,290	3,298	12,372	10,045
Total non-interest income	(8,369)	8,859	7,330	20,905
NON-INTEREST EXPENSE				

Salaries and employee benefits	16,376	16,893	50,643	50,756
Occupancy expense	3,393	3,159	9,918	9,035
Computer and equipment expense	1,848	2,432	6,024	7,209
Professional services expense	3,410	2,388	8,890	6,659
FDIC and State assessments	1,336	284	3,172	804
Marketing expense	584	608	2,449	2,413
Other real estate owned expense	1,182	23	1,806	284
Operations of affordable housing investments , net	2,840	2,540	5,361	4,928
Amortization of core deposit intangibles	1,722	1,767	5,196	5,298
Other operating expense	2,480	3,128	7,422	8,350
Total non-interest expense	35,171	33,222	100,881	95,736
Income before income tax expense	14,261	53,264	83,554	148,945
Income tax expense	7,370	19,258	30,133	54,392
Net income	6,891	34,006	53,421	94,553
Other comprehensive loss, net of tax				
Unrealized holding (losses)/gains arising during the period	(5,833)	5,968	(18,106)	2,358
Less: reclassification adjustments included in net income	(8,910)	(10)	(2,730)	(210)
Total other comprehensive loss, net of tax	3,077	5,978	(15,376)	2,568
Total comprehensive income	$ 9,968	$ 39,984	$ 38,045	$ 97,121
Net income per common share:				
Basic	$ 0.14	$ 0.68	$ 1.08	$ 1.87
Diluted	$ 0.14	$ 0.67	$ 1.08	$ 1.84
Cash dividends paid per common share	$ 0.105	$ 0.105	$ 0.315	$ 0.300
Basic average common shares outstanding	49,441,621	49,828,379	49,392,655	50,683,650
Diluted average common shares outstanding	49,530,272	50,417,332	49,497,171	51,283,317

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

CATHAY GENERAL BANCORP AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30 2008	2007
	(In thousands)	
Cash Flows from Operating Activities		
Net income	$ 53,421	$ 94,553
Adjustments to reconcile net income to net cash provided by operting activities:		
Provision for credit losses	43,800	5,300
Provision for losses on other real estate owned	1,248	210
Deferred tax benefit	(24,489)	(3,162)
Depreciation	3,184	3,183
Net gains on sale of other real estate owned	(75)	(29)
Net gains on sale of loans held for sale	(245)	(125)
Proceeds from sale of loans held for sale	10,599	2,532
Originations of loans held for sale	(10,395)	(2,375)
Purchase of trading securities	-	(5,000)
Write-downs on venture capital investments	270	630
Write-downs on impaired securities	33,654	-
Gain on sales and calls of securities	(20,674)	(268)
Decrease in fair value of warrants	26	90
Amortization of security premiums, net	1,651	1,310
Amortization of intangibles	5,277	5,474
Excess tax short-fall / (benefit) from share-based payment arrangements	240	(503)
Stock based compensation expense	5,828	5,694
Gain on sale of premises and equipment	(21)	(2,714)
Decrease / (increase) in accrued interest receivable	11,638	(14,775)
Decrease in other assets, net	7,519	2,238
Increase in other liabilities	5,028	10,637
Net cash provided by operating activities	127,484	102,900
Cash Flows from Investing Activities		
Increase in short-term investments	(2,907)	(773)
Decrease / (increase) in long-term investment	50,000	(50,000)
Decrease/ (increase) in securities purchased under agreements to resell	366,100	(360,000)
Purchase of investment securities available-for-sale	(1,503,844)	(944,144)
Proceeds from maturity and call of investment securities available-for-sale	819,939	231,465
Proceeds from sale of investment securities available-for-sale	586,932	101,169
Purchase of mortgage-backed securities available-for-sale	(1,580,092)	-
Proceeds from repayment and sale of mortgage-backed securities available-for-sale	1,391,236	107,909
Purchase of Federal Home Loan Bank stock	(4,765)	(15,248)
Redemption of Federal Home Loan Bank stock	5,498	1,093
Net increase in loans	(860,456)	(654,072)
Purchase of premises and equipment	(20,766)	(6,907)
Proceeds from sales of premises and equipment.	21	6,948
Proceeds from sale of other real estate owned	105	1,717

Net increase in investment in affordable housing		(11,517)		(10,873)
Acquisition, net of cash acquired		-		(3,655)
Net cash used in investing activities		(764,516)		(1,595,371)
Cash Flows from Financing Activities				
Net increase/(decrease) in demand deposits, NOW accounts, money market and saving deposits		187,385		(10,769)
Net increase in time deposits		383,418		352,103
Net increase in federal funds purchased and securities sold under agreement to repurchase		150,975		756,710
Advances from Federal Home Loan Bank		2,598,533		2,668,000
Repayment of Federal Home Loan Bank borrowings		(2,697,000)		(2,293,000)
Cash dividends		(15,555)		(15,294)
Issuance of long-term debt		-		65,000
Proceeds from other borrowings		20,629		22,351
Repayment of other borrowings		(28,930)		(29,000)
Proceeds from shares issued to Dividend Reinvestment Plan		1,931		1,837
Proceeds from exercise of stock options		372		1,416
Excess tax (short-fall)/benefits from share-based payment arrangements		(240)		503
Purchases of treasury stock		-		(76,908)
Net cash provided by financing activities		601,518		1,442,949
Decrease in cash and cash equivalents		(35,514)		(49,522)
Cash and cash equivalents, beginning of the period		118,437		132,798
Cash and cash equivalents, end of the period	$	82,923	$	83,276
Supplemental disclosure of cash flow information				
Cash paid during the period:				
Interest	$	226,210	$	217,353
Income taxes	$	56,699	$	51,679
Non-cash investing and financing activities:				
Net change in unrealized holding loss on securities available-for-sale, net of tax	$	(15,376)	$	2,568
Cumulative effect adjustment as result of adoption of FASB Interpretation No 48				
Adjustment to initially apply FASB Interpretation 48	$	-	$	(8,524)
Adjustment to initially apply EITF 06-4	$	(147)	$	-
Transfers to other real estate owned	$	28,357	$	373
Loans to facilitate the sale of other real estate owned	$	-	$	3,360
Loans to facilitate the sale of fixed assets	$	-	$	1,940

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

CATHAY GENERAL BANCORP AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

1. Business

Cathay General Bancorp (the "Bancorp") is the holding company for Cathay Bank (the "Bank"), six limited partnerships investing in affordable housing investments in which the Bank is the sole limited partner, and GBC Venture Capital, Inc. The Bancorp also owns 100% of the common stock of five statutory business trusts created for the purpose of issuing capital securities. The Bank was founded in 1962 and offers a wide range of financial services. As of September 30, 2008, the Bank operates twenty one branches in Southern California, ten branches in Northern California, nine branches in New York State, three branches in Illinois, three branches in Washington State, two branches Texas, one branch in Massachusetts, one branch in New Jersey, one branch in Hong Kong, and a representative office in Shanghai and in Taipei. Deposit accounts at the Hong Kong branch are not insured by the Federal Deposit Insurance Corporation (the "FDIC").

2. Acquisitions and Investments

We continue to look for opportunities to expand the Bank's branch network by seeking new branch locations and/or by acquiring other financial institutions to diversify our customer base in order to compete for new deposits and loans, and to be able to serve our customers more effectively.

For each acquisition, we developed an integration plan for the consolidated company that addressed, among other things, requirements for staffing, systems platforms, branch locations and other facilities. The established plans are evaluated regularly during the integration process and modified as required. Merger and integration expenses are summarized in the following primary categories: (i) severance and employee-related charges; (ii) system conversion and integration costs, including contract termination charges; (iii) asset write-downs, lease termination costs for abandoned space and other facilities-related costs; and (iv) other charges. Other charges include investment banking fees, legal fees, other professional fees relating to due diligence activities and expenses associated with preparation of securities filings, as appropriate. These costs were included in the allocation of the purchase price at the acquisition date based on our formal integration plans.

As of September 30, 2008, goodwill was $319.6 million, a decrease of $316,000 compared to December 31, 2007, due to a reversal of accrued penalties of $528,000 as a result of the settlement with the California Franchise Board for a claim related to GBC Bancorp's 2001 California tax return and a tax refund of $60,000 related to New Asia Bancorp's 2006 tax year offset by a $196,000 deferred tax receivable write-off of state net operating loss carry-forwards from United Heritage Bank and a $76,000 tax payment related to GBC Bancorp's 2002 California tax return. Merger-related lease liability was $464,000 as of September 30, 2008, with cash outlays of $45,000 for the three months and $142,000 for the nine months ended September 30, 2008.

3. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the audited consolidated financial statements and footnotes included in the Company’s annual report on Form 10-K for the year ended December 31, 2007.

The preparation of the consolidated financial statements in accordance with GAAP requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. The most significant estimate subject to change relates to the allowance for loan losses and goodwill impairment.

4. Recent Accounting Pronouncements

SFAS No. 141, “Business Combinations (Revised 2007).” SFAS 141R replaces SFAS 141, “Business Combinations,” and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities,” would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, “Accounting for Contingencies.” SFAS 141R is expected to have a significant impact on the Company’s accounting for business combinations closing on or after January 1, 2009.

In February 2008, the FASB issued Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company does not expect a material impact on its consolidated financial statements from adoption of SFAS 157-2. In October 2008, the FASB issued Staff Position (FSP) 157-3, *Determining the Fair Value of a Financial Assets When the Market for that Asset is not Active.* This FSP clarifies the application of FAS 157 in a market that is not active. SFAS 157-3 was effected upon issuance. The adoption of SFAS 157-3 did not have an impact on the Company’s consolidated financial statements

SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51." SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Company on January 1, 2009, and is not expected to have a significant impact on the Company's financial statements.

SFAS No. 162, "The Hierarchy of General Accepted Accounting Principles" SFAS 162 states that the business entity itself is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. This statement makes the GAAP hierarchy explicitly and directly applicable to preparers of financial statements. SFAS 162 is effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Company does not expect a material impact on its consolidated financial statements from adoption of SFAS 162.

Emerging Issues Task Force ("EITF") Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements." EITF 06-4 requires the recognition of a liability and related compensation expense for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to post-retirement periods. Under EITF 06-4, life insurance policies purchased for the purpose of providing such benefits do not effectively settle an entity's obligation to the employee. Accordingly, the entity must recognize a liability and related compensation expense during the employee's active service period based on the future cost of insurance to be incurred during the employee's retirement. If the entity has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions." The Company adopted EITF 06-4 effective as of January 1, 2008, and charged a $147,000 cumulative effect adjustment to the opening balance of retained earnings as of January 1, 2008.

EITF Issue No. 08-5, "Fair-Value Measurements of Liabilities with Third-Party Credit Enhancements." EITF 08-5 requires issuers of liability instruments with third-party credit enhancements to exclude the effect of the credit enhancement when measuring the liability's fair value. Upfront fees paid by the issuer for the credit enhancement would not be deferred for liabilities recorded at fair value. EITF 08-5 will be effective for the reporting period beginning after December 15, 2008. The Company does not expect a material impact on its consolidated financial statements from adoption of EITF 08-5.

EITF Issue No. 08-6, "Equity-Method Investment Accounting." EITF 08-6 concludes that the cost basis of a new equity-method investment would be determined using a cost-accumulation model, which would continue the practice of including transaction costs in the cost of investment and would exclude the value of contingent consideration. Equity-method investment should be subject to other-than-temporary impairment analysis. It also requires that a gain or loss to be recognized on the portion of the investor's ownership sold. EITF 08-6 will be effective for the reporting period beginning after December 15, 2008. The Company does not expect a material impact on its consolidated financial statements from adoption of EITF 08-6.

EITF Issue No. 08-7, "Defensive Intangible Assets." EITF 08-7 requires an acquiring entity to account defensive intangible assets as a separate unit of accounting. Defensive intangible assets should not be included as part of the cost of the acquirer's existing intangible assets because the defensive intangible assets are separately identifiable. Defensive intangible assets must be recognized at fair value in accordance with SFAS 141R and SFAS 157. EITF 08-7 will be effective for the reporting period beginning after December 15, 2008. The Company does not expect a material impact on its consolidated financial statements from adoption of EITF 08-7.

FASB Staff Positions ("FSP") Accounting Principles Board Opinions ("APB") Issue No. 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." APB 14-1 requires issuers of convertible debt that may be settled wholly or partly in cash to account for the debt and equity components separately. The APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not expect a material impact on its consolidated financial statements from adoption of APB 14-1.

5. Earnings per Share

Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and resulted in the issuance of common stock that then shared in earnings.

Outstanding stock options with anti-dilutive effect were not included in the computation of diluted earnings per share. The following table sets forth basic and diluted earnings per share calculations and the average shares of stock options with anti-dilutive effect:

	For the three months ended September 30,		For the nine months ended September 30,	
(Dollars in thousands, except share and per share data)	2008	2007	2008	2007
Net income	$ 6,891	$ 34,006	$ 53,421	$ 94,553
Weighted-average shares:				
Basic weighted-average number of common shares outstanding	49,441,621	49,828,379	49,392,655	50,683,650
Dilutive effect of weighted-average outstanding common shares equivalents				
Stock Options	83,147	580,602	102,398	593,503
Restricted Stock	5,504	8,351	2,118	6,164
Diluted weighted-average number of common shares outstanding	49,530,272	50,417,332	49,497,171	51,283,317
Average shares of stock options with anti-dilutive effect	4,808,696	1,438,436	4,429,533	1,446,152
Earnings per share:				
Basic	$ 0.14	$ 0.68	$ 1.08	$ 1.87
Diluted	$ 0.14	$ 0.67	$ 1.08	$ 1.84

6. Stock-Based Compensation

In 1998, the Board adopted the Cathay Bancorp, Inc. Equity Incentive Plan. Under the Equity Incentive Plan, as amended in September, 2003, directors and eligible employees may be granted incentive or non-statutory stock options and/or restricted stock units, or awarded non-vested stock, for up to 7,000,000 shares of the Company's common stock on a split adjusted basis. In May 2005, the stockholders of the Company approved the 2005 Incentive Plan which provides that 3,131,854 shares of the Company's common stock may be granted as incentive or non-statutory stock options, and/or restricted stock units, or as non-vested stock. In conjunction with the approval of the 2005 Incentive Plan, the Bancorp agreed to cease granting awards under the Equity Incentive Plan. As of September 30, 2008, the only options granted by the Company under the 2005 Incentive Plan were non-statutory stock options to selected bank officers and non-employee directors at exercise prices equal to the fair market value of a share of the Company's common stock on the date of grant. Such options have a maximum ten-year term and vest in 20% annual increments (subject to early termination in certain events) except options granted to the Chief Executive Officer of the Company for 245,060 shares granted on March 22, 2005, of which 30% vested immediately, 10% vested on November 20, 2005, 20% each vested on November 20, 2006 and on November 20, 2007, and an additional 20% would vest on November 20, 2008, 264,694 shares granted on May 22, 2005, of which 40% vested on November 20, 2005, 20% each vested on November 20, 2006 and on November 20, 2007, and an additional 20% would vest on November 20 2008, and 100,000 shares granted on February 21, 2008, of which 50% would vest on February 21, 2009, and the remaining 50% would vest on February 21, 2010. If such options expire or terminate without having been exercised, any shares not purchased will again be available for future grants or awards. Stock options are typically granted in the first quarter of the year. There were no options granted in 2007. The Board of Directors of the Company was in the process of reviewing the relative merits of granting restricted stock or restricted stock units either in place of or in combination with stock options. As a result, the Company deferred the granting of any stock option awards until 2008. In 2008, the Company granted options of 689,200 shares and restricted stock units of 82,291 shares to selected bank officers and non-employee directors. The Company expects to issue new shares to satisfy stock option exercises and the vesting of restricted stock units.

Stock-based compensation expense for stock options is calculated based on the fair value of the award at the grant date for those options expected to vest, and is recognized as an expense over the vesting period of the grant. The Company uses the Black-Scholes option pricing model to estimate the value of granted options. This model takes into account the option exercise price, the expected life, the current price of the underlying stock, the expected volatility of the Company's stock, expected dividends on the stock and a risk-free interest rate. The Company estimates the expected volatility based on the Company's historical stock prices for the period corresponding to the expected life of the stock options. Based on SAB 107 and SAB 110, the Company has estimated the expected life of the options based on the average of the contractual period and the vesting period and has consistently applied the simplified method to all options granted starting from 2005. Option compensation expense totaled $5.1 million for the nine months ended September 30, 2008, and $5.2 million for the nine months ended September 30, 2007. For the three months ended September 30, option compensation expense totaled $1.7 million for 2008 and $1.7 million for 2007. Stock-based compensation is recognized ratably over the requisite service period for all awards. Unrecognized stock-based compensation expense related to stock options totaled $11.8 million at September 30, 2008, and is expected to be recognized over the next 2.5 years.

The weighted average per share fair value on the date of grant of the options granted was $6.86 during the first quarter of 2008. There were no options granted in 2007 and in the second quarter and third quarter of 2008. The Company estimated the expected life of the options based on the average of the contractual period and the vesting period. The fair value of stock options has been determined using the Black-Scholes option pricing model with the following assumptions:

	Nine months ended September 30, 2008
Expected life- number of years	6.4
Risk-free interest rate	3.09%
Volatility	30.04%
Dividend yield	1.80%

During the nine-month period, exercised option shares were 20,906 shares in 2008 and 84,236 shares in 2007. Exercised options shares were 2,000 shares for the third quarter of 2008 and 6,000 shares for the third quarter of 2007. The table below summarizes cash received and aggregate intrinsic value from options exercised:

	For the three months ended September 30,		For the nine months ended September 30,	
(In thousands, except shares)	2008	2007	2008	2007
Shares of option exercised	2,000	6,000	20,906	84,236
Cash received from option exercised	$ 17	$ 75	$ 372	$ 1,416
Aggregate intrinsic value for option exercised	$ 28	$ 132	$ 136	$ 1,420

The table below summarizes stock option activity for the periods indicated:

	Shares	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Life (in years)**	**Aggregate Intrinsic Value (in thousands)**
Balance at December 31, 2007	4,574,280	$ 28.36	6.1	$ 24,487
Granted	689,200	23.37		
Forfeited	(16,784)	32.63		
Exercised	(18,906)	18.81		
Balance at March 31, 2008	5,227,790	$ 27.72	6.4	$ 2,901
Granted	-	-		
Forfeited	(4,822)	33.53		
Exercised	-	-		
Balance at June 30, 2008	5,222,968	$ 27.72	6.1	$ 28
Granted	-	-		
Forfeited	(8,258)	30.40		
Exercised	(2,000)	8.25		
Balance at September 30, 2008	5,212,710	$ 27.72	5.9	$ 6,221
Exercisable at September 30, 2008	3,418,587	$ 26.69	4.9	$ 5,926

At September 30, 2008, 1,542,022 shares were available under the Company’s 2005 Incentive Plan for future grants.

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The Company grants non-vested stock to its Chairman of the Board, President, and Chief Executive Officer. The shares vest ratably over certain years if certain annual performance criteria are met. The following table presents information relating to the non-vested stock grants as of September 30, 2008:

	Date Granted	
	January 31, 2007	January 25, 2006
Shares granted	20,000	30,000
Vested ratably over	2 years	3 years
Price per share at grant date	$ 34.66	$ 36.24
Vested shares	10,000	20,000
Non-vested shares	10,000	10,000

The stock compensation expense recorded related to the non-vested stock above was $532,000 for the nine months ended September 30, 2008, and $503,000 for the nine months ended September 30, 2007. For the three months ended September 30, non-vested stock compensation expense was $177,000 for 2008 and $177,000 for 2007. Unrecognized stock-based compensation expense related to non-vested stock awards was $236,000 at September 30, 2008, and is expected to be recognized over the next 4 months.

In addition to stock options and restricted stock awards above, in February 2008, the Company also granted restricted stock units on 82,291 shares of the Company's common stock to its eligible employees. On the date of granting of these restricted stock units, the closing price of the Company's stock was $23.37 per share. Such restricted stock units have a maximum term of five years and vest in approximately 20% annual increments subject to employees' continued employment with the Company. The following table presents information relating to the restricted stock units grant as of September 30, 2008:

	Units	**Weighted-Average Remaining Contractual Life (in years)**
Balance at December 31, 2007	-	-
Granted	82,291	3.0
Forfeited	(2,191)	
Balance at September 30, 2008	80,100	2.4

The compensation expense recorded related to the restricted stock units above was $82,000 for the three months ended and $191,000 for the nine months ended September 30, 2008. Unrecognized stock-based compensation expense related to restricted stock units was $1.4 million at September 30, 2008, and is expected to be recognized over the next 4.4 years.

Prior to 2006, the Company presented the entire amount of the tax benefit on options exercised as operating activities in the consolidated statements of cash flows. After adoption of SFAS No. 123R in January 2006, the Company reports only the benefits of tax deductions in excess of grant-date fair value as cash flows from operating activity and financing activity. The following table summarizes the tax benefit (short-fall) from share-based payment arrangements:

(Dollars in thousands)	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
(Short-fall)/Benefit of tax deductions in excess of grant-date fair value	$ (3)	$ 53	$ (240)	$ 503
Benefit of tax deductions on grant-date fair value	15	3	297	94
Total benefit of tax deductions	$ 12	$ 56	$ 57	$ 597

7. Securities Purchased Under Agreements to Resell

Securities purchased under agreements to resell are usually collateralized by U.S. government agency and mortgage-backed securities. The counter-parties to these agreements are nationally recognized investment banking firms that meet credit requirements of the Company and with whom a master repurchase agreement has been duly executed. As of September 30, 2008, the Company had three outstanding long-term resale agreements totaling $150.0 million compared to nine long-term resale agreements totaling $450.0 million at December 31, 2007. The agreements have terms from seven to ten years with interest rates ranging from 7.00% to 7.15%. The counterparty has the right to a quarterly call. All $150.0 million resale agreements are callable as of September 30, 2008. When the callable term starts if certain conditions are met, there may be no interest earned for those days when the certain conditions are met.

Securities purchased under agreements to resell were $150.0 million at a weighted average interest rate of 7.10% at September 30, 2008, compared to $516.1 million at a weighted average interest rate of 7.44% at December 31, 2007.

For those securities obtained under the resale agreements, the collateral is either held by a third party custodian or by the counter-party and is segregated under written agreements that recognize the Company’s interest in the securities. Interest income associated with securities purchased under resale agreements totaled $2.8 million for the third quarter of 2008 and $12.0 million for the first nine months of 2008 compared to $7.4 million for the same quarter a year ago and to $14.7 million for the first nine months of 2007.

8. Commitments and Contingencies

In the normal course of business, the Company becomes a party to financial instruments with off-balance sheet risk to meet the financing needs of its customers. These financial instruments include commitments to extend credit in the form of loans, or through commercial or standby letters of credit, and financial guarantees. These instruments represent varying degrees of exposure to risk in excess of the amounts included in the accompanying condensed consolidated balance sheets. The contractual or notional amount of these instruments indicates a level of activity associated with a particular class of financial instrument and is not a reflection of the level of expected losses, if any.

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The following table summarizes the outstanding commitments as of the dates indicated:

(In thousands)	At September 30, 2008	At December 31, 2007
Commitments to extend credit	$ 2,089,619	$ 2,310,887
Standby letters of credit	73,844	62,413
Other letters of credit	70,434	71,089
Bill of lading guarantees	353	323
Total	$ 2,234,250	$ 2,444,712

As of September 30, 2008, $25.7 million unfunded commitments for affordable housing investments were recorded under other liabilities compared to $19.2 million at December 31, 2007.

Commitments to extend credit are agreements to lend to a customer provided there is no violation of any condition established in the commitment agreement. These commitments generally have fixed expiration dates and the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer’s creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the borrower. Letters of credit, including standby letters of credit and bill of lading guarantees, are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing these types of instrument is essentially the same as that involved in making loans to customers.

9. Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase were $1.6 billion with a weighted average rate of 3.83% at September 30, 2008, compared to $1.4 billion with a weighted average rate of 3.57% at December 31, 2007. Seventeen floating-to-fixed rate agreements totaling $900.0 million are with initial floating rates for a period of time ranging from six months to one year, with the floating rates ranging from the three-month LIBOR minus 100 basis points to the three-month LIBOR minus 340 basis points. Thereafter, the rates are fixed for the remainder of the term, with interest rates ranging from 4.29% to 5.07%. After the initial floating rate term, the counterparties have the right to terminate the transaction at par at the fixed rate reset date and quarterly thereafter. Thirteen fixed-to-floating rate agreements totaling $650.0 million are with initial fixed rates ranging from 1.00% and 3.50% with initial fixed rate terms ranging from six months to eighteen months. For the remainder of the seven year term, the rates float at 8% minus the three-month LIBOR rate with a maximum rate ranging from 3.25% to 3.75% and minimum rate of 0.0%. After the initial fixed rate term, the counterparties have the right to terminate the transaction at par at the floating rate reset date and quarterly thereafter.

At September 30, 2008, included in long-term transactions are twenty-three repurchase agreements totaling $1.2 billion that were callable but which had not been called. Six fixed-to-floating rate repurchase agreements of $50.0 million each have variable interest rates currently at a range from 3.50% to 3.75% maximum rate until their final maturities in September 2014. Four floating-to-fixed rate repurchase agreements of $50.0 million each have fixed interest rates ranging from 4.89% to 5.07%, until their final maturities in January 2017. Ten floating-to-fixed rate repurchase agreements totaled $550.0 million have fixed interest rates ranging from 4.29% to 4.78%, until their final maturities in 2014. Two floating-to-fixed rate repurchase agreements of $50.0 million each have fixed interest rates at 4.75% and 4.79%, until their final maturities in 2011. One floating-to-fixed rate repurchase agreement of $50.0 million has fixed interest rate at 4.83% until its final maturity in 2012.

These transactions are accounted for as collateralized financing transactions and recorded at the amounts at which the securities were sold. The Company may have to provide additional collateral for the repurchase agreements, as necessary. The underlying collateral pledged for the repurchase agreements consists of U.S. Treasury securities, U.S. government agency security debt, and mortgage-backed securities with a fair value of $1.7 billion as of September 30, 2008, and $1.5 billion as of December 31, 2007.

10.Advances from the Federal Home Loan Bank

Total advances from the FHLB of San Francisco decreased $98.5 million to $1.3 billion at September 30, 2008 from $1.4 billion at December 31, 2007. Non-puttable advances totaled $576.7 million with a weighted rate of 3.54% and puttable advances totaled $700.0 million with a weighted average rate of 4.42% at September 30, 2008. The FHLB has the right to terminate the puttable transaction at par at each three-month anniversary after the first puttable date. FHLB advances of $300.0 million at a weighted average rate of 4.31% were puttable as of September 30, 2008. The remaining puttable FHLB advances of $400.0 million at a weighted average rate of 4.50% are puttable at the second anniversary date in 2009.

11. Subordinated Note and Junior Subordinated Debt

On September 29, 2006, the Bank issued $50.0 million in subordinated debt in a private placement transaction. This instrument matures on September 29, 2016, and bears interest at a per annum rate based on the three month LIBOR plus 110 basis points, payable on a quarterly basis. At September 30, 2008, the per annum interest rate on the subordinated debt was 4.86% compared to 5.93% at December 31, 2007. The subordinated debt was issued through the Bank and qualifies as Tier 2 capital for regulatory reporting purposes and is included in long-term debt in the accompanying condensed consolidated balance sheets.

The Bancorp established three special purpose trusts in 2003 and two in 2007 for the purpose of issuing trust preferred securities to outside investors (Capital Securities). The trusts exist for the purpose of issuing the Capital Securities and investing the proceeds thereof, together with proceeds from the purchase of the common stock of the trusts by the Bancorp, in junior subordinated notes issued by the Bancorp. The five special purpose trusts are considered variable interest entities under FIN 46R. Because the Bancorp is not the primary beneficiary of the trusts, the financial statements of the trusts are not included in the consolidated financial statements of the Company. At September 30, 2008, junior subordinated debt securities totaled $121.1 million with a weighted average interest rate of 5.24% compared to $121.1 million with a weighted average rate of 7.13% at December 31, 2007. The junior subordinated debt securities have a stated maturity term of 30 years and are currently included in the Tier 1 capital of the Bancorp for regulatory capital purposes.

12. Implementation of FASB Interpretation No. 48

As previously disclosed, on December 31, 2003, the California Franchise Tax Board (FTB) announced its intent to list certain transactions that in its view constitute potentially abusive tax shelters. Included in the transactions subject to this listing were transactions utilizing regulated investment companies (RICs) and real estate investment trusts (REITs). While the Company continues to believe that the tax benefits recorded in 2000, 2001, and 2002 with respect to its regulated investment company were appropriate and fully defensible under California law, the Company participated in Option 2 of the Voluntary Compliance Initiative of the Franchise Tax Board, and paid all California taxes and interest on these disputed 2000 through 2002 tax benefits, and at the same time filed a claim for refund for these years while avoiding certain potential penalties. The Company retains potential exposure for assertion of an accuracy-related penalty should the FTB prevail in its position in addition to the risk of not being successful in its refund claims. In June 2008, the Company received a notice from the FTB indicating that the FTB intends to deny the Company's claim for refund for its 2000 through 2002 tax years. The Company is in discussions with the FTB to resolve this matter.

The FASB issued Interpretation No. 48 Accounting for Uncertainty in Income Taxes ("FIN 48") which requires that the amount of recognized tax benefit should be the maximum amount which is more-likely-than-not to be realized and that amounts previously recorded that do not meet the requirements of FIN 48 be charged as a cumulative effect adjustment to retained earnings. As of December 31, 2006, the Company reflected a $12.1 million net state tax receivable related to payments it made in April 2004 under the Voluntary Compliance Initiative program for the years 2000, 2001, and 2002, after giving effect to reserves for loss contingencies on the refund claims. The Company has determined that its refund claim related to its regulated investment company is not more-likely-than-not to be realized and consequently, charged a total of $8.5 million, comprised of the $7.9 million after tax amount related to its refund claims as well as a $0.6 million after tax amount related to California Net Operating Losses generated in 2001 as a result of its regulated investment company, to the balance of retained earnings as of the January 1, 2007, the effective date of FIN 48.

At the January 1, 2007, adoption date of FIN 48, the total amount of the Company's unrecognized tax benefits was $5.5 million, of which $1.6 million, if recognized, would affect the effective tax rate. The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. At January 1, 2007, the adoption date of FIN 48, the total amount of accrued interest and penalties was $1.7 million. In February 2008, the Company withdrew, with the agreement of the California Franchise Tax Board, a claim related to GBC Bancorp's 2001 California tax return and reversed $0.5 million of accrued penalties with a corresponding decrease in goodwill. The amount of additional unrecognized tax benefits expected to be recognized during 2008 is not expected to be significant.

The Company's tax returns are open for audits by the Internal Revenue Service back to 2004 and by the Franchise Tax Board of the State of California back to 2000. The Company is currently under audit by the California Franchise Tax Board for the years 2000 to 2004. During the second quarter of 2007, the Internal Revenue Service completed an examination of the Company's 2004 and 2005 tax returns and did not propose any adjustments deemed to be material.

13. Stock Repurchase Program

On November 2007, the Company announced that its Board of Directors had approved a new stock repurchase program to buy back up to an aggregate of one million shares of the Company's common stock following the completion of the stock repurchase program of May 2007. During 2007, the Company repurchased 2,829,203 shares of common stock for $92.4 million, or an average price of $32.67 per share. No shares were purchased during the first nine months of 2008. At September 30, 2008, 622,500 shares remain under the Company's November 2007 repurchase program.

14. Fair Value Measurements

SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Company adopted SFAS No. 157 on January 1, 2008, and determined the fair values of our financial instruments based on the three-level fair value hierarchy established in SFAS 157. The three-level inputs to measure the fair value of assets and liabilities are as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Observable prices in active markets for similar assets or liabilities; prices for identical or similar assets or liabilities in markets that are not active; directly observable market inputs for substantially the full term of the asset and liability; market inputs that are not directly observable but are derived from or corroborated by observable market data.
- Level 3 – Unobservable inputs based on the Company's own judgments about the assumptions that a market participant would use.

The Company uses the following methodologies to measure the fair value of its financial assets on a recurring basis:

Securities available for sale- For certain actively traded trust preferred securities, agency preferred stocks, and U.S. Treasury securities, the Company measures the fair value based on quoted market prices in active exchange markets at the reporting date, a Level 1 measurement. The Company measures all other securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement. This category generally includes U.S. Government agency securities, state and municipal securities, mortgage-backed securities ("MBS"), commercial MBS, collateralized mortgage obligations, asset-backed securities and corporate bonds.

Trading securities- The Company measures the fair value of trading securities based on quoted market prices in active exchange markets at the reporting date, a Level 1 measurement.

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

Equity investment- The Company does not record equity investment at fair value on a recurring basis. However, from time to time, nonrecurring fair value adjustments to equity investment are recorded based on quoted market prices in active exchange market at the reporting date, a Level 1 measurement.

Warrants- The Company measures the fair value of warrants based on unobservable inputs based on assumption and management judgment, a Level 3 measurement.

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring and non-recurring basis at September 30, 2008:

	Fair Value Measurements Using			Total at
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets				
On a Recurring Basis				
Securities available-for-sale	$ 77,374	$ 2,514,957	$ -	$ 2,592,331
Trading securities	19	-	-	19
Warrants	-	-	108	108
On a Non-recurring Basis				
Impaired loans	-	37,252	7,074	44,326
Equity investment	1,868	-	-	1,868
Total assets	$ 79,261	$ 2,552,209	$ 7,182	$ 2,638,652

The Company measured the fair value of its warrants on a recurring basis using significant unobservable inputs. The fair value of warrants was $108,000 at September 30, 2008, compared to $125,000 at December 31, 2007. The fair value adjustment of $17,000 was included in other operating income during the first nine months of 2008.

15. Goodwill and Goodwill Impairment

The Company's policy is to assess goodwill for impairment at the reporting unit level on an annual basis or between annual assessments if an triggering event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Accounting standards require management to estimate the fair value of each reporting unit in making the assessment of impairment at least annually.

As a result of ongoing volatility in the financial services industry, the Company's market capitalization decreased to a level below book value as of June 30, 2008. The Company engaged an independent valuation firm to compute the fair value estimates of each reporting unit as part of its impairment assessment. The independent valuation utilized two separate valuation methodologies and applied a weighted average to each methodology in order to determine fair value for each reporting unit.

The impairment testing process conducted by the Company begins by assigning net assets and goodwill to its three reporting units- Commercial Lending, Retail Banking, and East Coast Operations. The Company then completes "step one" of the impairment test by comparing the fair value of each reporting unit (as determined based on the discussion below) with the recorded book value (or "carrying amount") of its net assets, with goodwill included in the computation of the carrying amount. If the fair value of a reporting unit exceeds its carrying amount, goodwill of that reporting unit is not considered impaired, and "step two" of the impairment test is not necessary. If the carrying amount of a reporting unit exceeds its fair value, step two of the impairment test is performed to determine the amount of impairment. Step two of the impairment test compares the carrying amount of the reporting unit's goodwill to the "implied fair value" of that goodwill. The implied fair value of goodwill is computed by assuming all assets and liabilities of the reporting unit would be adjusted to the current fair value, with the offset as an adjustment to goodwill. This adjusted goodwill balance is the implied fair value used in step two. An impairment charge is recognized for the amount by which the carrying amount of goodwill exceeds its implied fair value. In connection with obtaining the independent valuation, management provided certain data and information that was utilized by the third party in its determination of fair value. This information included forecasted earnings of the Company at the reporting unit level. Management believes that this information is a critical assumption underlying the estimate of fair value.

The valuation as of June 30, 2008, indicated that the fair value for the Retail Banking and East Coast Operations, the only two reporting units with allocated goodwill, exceeded their carrying amounts. Consequently, no goodwill impairment charge was recorded as of June 30, 2008. While management uses the best information available to estimate future performance for each reporting unit, future adjustments to management's projections may be necessary if conditions differ substantially from the assumptions used in making the estimates. At September 30, 2008, the Company's market capitalization was above book value and there was no triggering event that required the Company to assess goodwill for impairment.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion is given based on the assumption that the reader has access to and has read the Annual Report on Form 10-K for the year ended December 31, 2007, of Cathay General Bancorp ("Bancorp") and its wholly-owned subsidiary Cathay Bank (the "Bank" and, together, the "Company" or "we", "us," or "our").

Recent Developments

There have been significant disruptions in the U.S. and international financial system during the period covered by this report. As a result, available credit has been reduced or ceased to exist. The availability of credit, confidence in the entire financial sector, and volatility in financial markets has been adversely affected. The U.S. government, the governments of other countries, and multinational institutions have provided vast amounts of liquidity and capital into the banking system.

In response to the financial crises affecting the overall banking system and financial markets in the United States, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 ("EESA") was enacted to provide up to $700 billion to the United States Department of Treasury ("U.S. Treasury") to purchase mortgages, mortgage backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, under the authority of EESA, the U.S. Treasury announced the Troubled Asset Relief Program ("TARP") Capital Purchase Program. Under this program, the U.S. Treasury will purchase up to $250 billion of senior preferred shares from qualified U.S. financial institutions. The general terms of the senior preferred investment include:

- senior preferred shares will pay cumulative compounding dividends at a rate of 5 percent per year for the first five years, and thereafter at a rate of 9 percent per year;

- senior preferred shares are non-voting, other than class voting rights on matters that could adversely affect the shares;
- senior preferred shares will be callable at par after three years. Prior to the end of three years, the senior preferred shares may only be redeemed with the proceeds from one or more qualified equity offerings;
- in conjunction with the purchase of senior preferred shares, the U.S. Treasury will receive warrants to purchase common stock with an aggregate market price equal to 15 percent of the senior preferred amount based on the date of investment. Exercise price on warrants shall be the market price of the participating institutions' common stock based on the date the U.S. Treasury accepts the financial institution's application to participate in the program and uses a 20-trading day trailing average;
- common stock dividends cannot be increased for three years while the U.S. Treasury is an investor unless preferred stock is redeemed, has been transferred to third parties, or consent from the U.S. Treasury is received;
- participating institutions must also adopt the U.S. Treasury's standards for executive compensation and corporate governance, for the period during which the U.S. Treasury holds equity issued under this program.

The terms of this Capital Purchase Program could reduce investment returns to participating banks' shareholders by restricting dividends to common shareholders, diluting existing shareholders' interests, and restricting capital management practices. Although both the Company and its banking subsidiary meet all applicable regulatory capital requirements and remain well capitalized, the Company has applied for participation in the Capital Purchase Program.

Federal and state governments could pass additional legislation responsive to current credit conditions. As an example, the Company could experience higher credit losses because of federal or state legislation or regulatory action that reduces the principal amount or interest rate under existing loan contracts. Also, the Company could experience higher credit losses because of federal or state legislation or regulatory action that limits the Bank's ability to foreclose on property or other collateral or makes foreclosure less economically feasible.

The Federal Deposit Insurance Corporation ("FDIC") insures deposits at FDIC insured financial institutions up to certain limits. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund. Current economic conditions have increased expectations for bank failures, in which case the FDIC would take control of failed banks and ensure payment of deposits up to insured limits using the resources of the Deposit Insurance Fund. In such case, the FDIC may increase premium assessments to maintain adequate funding of the Deposit Insurance Fund, including requiring riskier institutions to pay a larger share of the premiums. An increase in premium assessments would increase the Company's expenses. The EESA included a provision for a temporary increase in the amount of deposits insured by FDIC to $250,000 until December 2009. On October 14, 2008, the FDIC announced a new program — the Temporary Liquidity Guarantee Program that provides unlimited deposit insurance coverage on funds in non-interest bearing transaction deposit accounts not otherwise covered by the existing temporary deposit insurance limit of $250,000. All eligible institutions will be covered under the program for the first 30 days without incurring any costs. After the initial period, participating institutions will be assessed an annualized 10 basis point surcharge on the additional insured deposits. The behavior of depositors in regard to the level of FDIC insurance could cause the Bank's existing customers to reduce the amount of deposits held at the Bank, and or could cause new customers to open deposit accounts at the Bank. The level and composition of the Bank's deposit portfolio directly impacts the Bank's funding cost and net interest margin. As a result of these measures, it is likely that the premiums the Bank pays for FDIC insurance will increase, which would adversely affect net income. The impact of such measures cannot be assessed at this time.

The actions described above, together with additional actions announced by the U.S. Treasury and other regulatory agencies continue to develop. It is not clear at this time what impact, EESA, TARP, other liquidity and funding initiatives of the U.S. Treasury and other bank regulatory agencies that have been previously announced, and any additional programs that may be initiated in the future will have on the financial markets and the financial services industry. The extreme levels of volatility and limited credit availability currently being experienced could continue to effect the U.S. banking industry and the broader U.S. and global economies, which will have an affect on all financial institutions, including the Company.

Critical Accounting Policies

The discussion and analysis of the Company's unaudited condensed consolidated balance sheets and results of operations are based upon its unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Accounting for the allowance for credit losses involves significant judgments and assumptions by management, which have a material impact on the carrying value of net loans; management considers this accounting policy to be a critical accounting policy. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances as described under the heading "Accounting for the Allowance for Loan Losses" in the Company's annual report on Form 10-K for the year ended December 31, 2007.

Accounting for investment securities involves significant judgments and assumptions by management, which have a material impact on the carrying value of securities and the recognition of any "other-than-temporary" impairment to our investment securities. The judgments and assumptions used by management are described under the heading "Investment Securities" in the Company's annual report on Form 10-K for the year ended December 31, 2007.

Accounting for income taxes involves significant judgments and assumptions by management, which have a material impact on the amount of taxes currently payable and the income tax expense recorded in the financial statements. The judgments and assumptions used by management are described under the heading "Income Taxes" in the Company's annual report on Form 10-K for the year ended December 31, 2007.

Under SFAS No. 142, Goodwill and Other Intangibles, goodwill must be allocated to reporting units and tested for impairment. The Company tests goodwill for impairment at least annually or more frequently if events or circumstances, such as adverse changes in the business, indicate that there may be justification for conducting an interim test. Impairment testing is performed at the reporting-unit level utilizing an independent valuation. The Company then completes "step one" of the impairment test by comparing the fair value of each reporting unit (as determined based on the discussion above) with the recorded book value (or "carrying amount") of its net assets, with goodwill included in the computation of the carrying amount. If the fair value of a reporting unit exceeds its carrying amount, goodwill of that reporting unit is not considered impaired, and "step two" of the impairment test is not necessary. If the carrying amount of a reporting unit exceeds its fair value, step two of the impairment test is performed to determine the amount of impairment. Step two of the impairment test compares the carrying amount of the reporting unit's goodwill to the "implied fair value" of that goodwill. The implied fair value of goodwill is computed by assuming all assets and liabilities of the reporting unit would be adjusted to the current fair value, with the offset as an adjustment to goodwill. This adjusted goodwill balance is the implied fair value used in step two. An impairment charge is recognized for the amount by which the carrying amount of goodwill exceeds its implied fair value.

In connection with obtaining the independent valuation, management provides certain data and information that is utilized by the third party in its determination of fair value. This information includes forecasted earnings of the Company at the reporting unit level. Management believes that this information is a critical assumption underlying the estimate of fair value.

HIGHLIGHTS

- Third quarter earnings of $6.9 million decreased $27.1 million, or 79.7%, compared to the same quarter a year ago.
- Fully diluted earnings per share was $0.14, a 79.1% decrease from the same quarter a year ago.
- Return on average assets was 0.25% for the quarter ended September 30, 2008, compared to 0.73% for the quarter ended June 30, 2008, and compared to 1.46% for the same quarter a year ago.
- Return on average stockholders' equity was 2.71% for the quarter ended September 30, 2008, compared to 7.66% for the quarter ended June 30, 2008, and compared to 14.45% for the same quarter a year ago.
- Gross loans increased by $171.6 million, or 2.3%, for the quarter to $7.5 billion at September 30, 2008, from $7.3 billion at June 30, 2008.
- Total deposits increased by $107.1 million, or 1.6%, for the quarter to $6.8 billion at September 30, 2008, from $6.7 billion at June 30, 2008.

Income Statement Review

Net Income

Net income for the third quarter of 2008 was $6.9 million, or $0.14 per diluted share, a $27.1 million, or 79.7%, decrease compared with net income of $34.0 million, or $0.67 per diluted share for the same quarter a year ago. Return on average assets was 0.25% and return on average stockholders' equity was 2.71% for the third quarter of 2008 compared with a return on average assets of 1.46% and a return on average stockholders' equity of 14.45% for the third quarter of 2007.

Financial Performance

	Third Quarter 2008	Third Quarter 2007
Net income	$ 6.9 million	$ 34.0 million
Basic earnings per share	$ 0.14	$ 0.68
Diluted earnings per share	$ 0.14	$ 0.67
Return on average assets	0.25%	1.46%
Return on average stockholders' equity	2.71%	14.45%
Efficiency ratio	53.92%	37.46%

Net Interest Income Before Provision for Credit Losses

Net interest income before provision for credit losses decreased to $73.6 million during the third quarter of 2008, a decline of $6.2 million, or 7.8%, compared to the $79.8 million during the same quarter a year ago. The decrease was due primarily to the decline in the net interest margin which was partially offset by strong growth in loans and investment securities.

The net interest margin, on a fully taxable-equivalent basis, was 2.88% for the third quarter of 2008. The net interest margin decreased 6 basis points from 2.94% in the second quarter of 2008 and decreased 81 basis points from 3.69% in the third quarter of 2007. The decrease in the net interest margin from the prior year primarily resulted from the lag in the downward repricing of certificates of deposit following the decreases in the prime rate, a change in the mix of investment securities, and the increase in the borrowing rate on our long term repurchase agreements. The decrease in the net interest margin from the second quarter primarily resulted from the increase in the borrowing rates on securities sold under agreements to repurchase and other borrowed funds.

For the third quarter of 2008, the yield on average interest-earning assets was 5.70% on a fully taxable-equivalent basis, and the cost of funds on average interest-bearing liabilities equaled 3.21%. In comparison, for the third quarter of 2007, the yield on average interest-earning assets was 7.34% and cost of funds on average interest-bearing liabilities equaled 4.24%. The interest spread, defined as the difference between the yield on average interest-earning assets and the cost of funds on average interest-bearing liabilities, decreased 61 basis points to 2.49% for the quarter ended September 30, 2008, from 3.10% for the same quarter a year ago, primarily due to the reasons discussed above.

Average daily balances, together with the total dollar amounts, on a taxable-equivalent basis, of interest income and interest expense, and the weighted-average interest rate and net interest margin are as follows:

Interest-Earning Assets and Interest-Bearing Liabilities

Three months ended September 30,	2008			2007		
Taxable-equivalent basis (Dollars in thousands)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)(2)	Average Balance	Interest Income/ Expense	Average Yield/ Rate (1)(2)
Interest Earning Assets						
Commercial loans	$ 1,606,864	$ 21,171	5.24%	$ 1,320,611	$ 27,110	8.14%
Residential mortgage	772,460	10,983	5.69	622,793	9,769	6.27
Commercial mortgage	4,126,133	68,364	6.59	3,560,243	68,869	7.67
Real estate construction loans	898,728	13,247	5.86	768,117	17,801	9.19
Other loans and leases	21,633	240	4.41	26,688	376	5.59
Total loans and leases (1)	7,425,818	114,005	6.11	6,298,452	123,925	7.81
Taxable securities	2,484,473	27,575	4.42	1,769,245	25,127	5.63
Tax-exempt securities (3)	47,938	868	7.20	55,217	921	6.62
Federal Home Loan Bank Stock	64,228	1,004	6.22	50,297	639	5.04
Interest bearing deposits	8,941	42	1.87	71,843	1,248	6.89
Federal funds sold & securities purchased under agreements to resell	188,522	2,899	6.12	371,413	7,615	8.13
Total interest-earning assets	10,219,920	146,393	5.70	8,616,467	159,475	7.34
Non-interest earning assets						
Cash and due from banks	82,102			84,176		
Other non-earning assets	724,950			639,999		
Total non-interest earning assets	807,052			724,175		
Less: Allowance for loan losses	(90,162)			(65,902)		
Deferred loan fees	(10,527)			(11,584)		
Total assets	$ 10,926,283			$ 9,263,156		
Interest bearing liabilities:						
Interest bearing demand accounts	$ 268,802	$ 382	0.57	$ 233,116	$ 755	1.28
Money market accounts	760,679	3,466	1.81	699,679	5,610	3.18
Savings accounts	337,538	261	0.31	342,971	873	1.01
Time deposits	4,708,290	39,217	3.31	3,935,125	47,305	4.77
Total interest-bearing deposits	6,075,309	43,326	2.84	5,210,891	54,543	4.15
Federal funds purchased	39,842	206	2.06	22,863	279	4.84
Securities sold under agreements to repurchase	1,550,000	15,174	3.89	1,041,577	9,865	3.76
Other borrowings	1,157,430	11,785	4.05	978,759	11,475	4.65
Long-term debt	171,136	2,030	4.72	171,136	3,182	7.38
Total interest-bearing liabilities	8,993,717	72,521	3.21	7,425,226	79,344	4.24

Non-interest bearing liabilities						
Demand deposits	788,028			774,513		
Other liabilities	134,035			129,855		
Stockholders' equity	1,010,503			933,562		
Total liabilities and stockholders' equity	$ 10,926,283			$ 9,263,156		
Net interest spread (4)			2.49%			3.10%
Net interest income (4)		$ 73,872			$ 80,131	
Net interest margin (4)			**2.88%**			**3.69%**

(1) Yields and amounts of interest earned include loan fees. Non-accrual loans are included in the average balance.
(2) Calculated by dividing net interest income by average outstanding interest-earning assets
(3) The average yield has been adjusted to a fully taxable-equivalent basis for certain securities of states and political subdivisions and other securities held using a statutory Federal income tax rate of 35%
(4) Net interest income, net interest spread, and net interest margin on interest-earning assets have been adjusted to a fully taxable-equivalent basis using a statutory Federal income tax rate of 35%

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The following table summarizes the changes in interest income and interest expense attributable to changes in volume and changes in interest rates:

Taxable-Equivalent Net Interest Income — Changes Due to Rate and Volume(1)

(Dollars in thousands)	Three months ended September 30, 2008-2007 Increase (Decrease) in Net Interest Income Due to: Changes in Volume	Changes in Rate	Total Change
Interest-Earning Assets:			
Loans and leases	19,664	(29,584)	(9,920)
Taxable securities	8,619	(6,171)	2,448
Tax-exempt securities (2)	(128)	75	(53)
Federal Home Loan Bank Stock	198	167	365
Deposits with other banks	(658)	(548)	(1,206)
Federal funds sold and securities purchased under agreements to resell	(3,137)	(1,579)	(4,716)
Total increase in interest income	24,558	(37,640)	(13,082)
Interest-Bearing Liabilities:			
Interest bearing demand accounts	100	(473)	(373)
Money market accounts	445	(2,589)	(2,144)
Savings accounts	(14)	(598)	(612)
Time deposits	8,049	(16,137)	(8,088)
Federal funds purchased	138	(211)	(73)
Securities sold under agreements to repurchase	4,940	369	5,309
Other borrowed funds	1,903	(1,593)	310
Long-term debts	-	(1,152)	(1,152)
Total increase in interest expense	15,561	(22,384)	(6,823)
Changes in net interest income	$ 8,997	$ (15,256)	$ (6,259)