HANMI FINANCIAL CORP
Form 10-K
March 16, 2006

Table of Contents

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

Form 10-K

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the Fiscal Year Ended December 31, 2005
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the Transition Period From To

Commission File Number: 000-30421

HANMI FINANCIAL CORPORATION
(Exact Name of Registrant as Specified in its Charter)

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

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

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

Title of Each Class	Name of Each Exchange on Which Registered
None	None

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

Common Stock, $.001 Par Value
(Title of Class)

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

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

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

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

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

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

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

As of June 30, 2005, the aggregate market value of the common stock held by non-affiliates of the Registrant was approximately $670,043,000. For purposes of the foregoing calculation only, in addition to affiliated companies, all directors and officers of the Registrant have been deemed affiliates.

Number of shares of common stock of the Registrant outstanding as of February 28, 2006 was 48,851,968 shares.

Documents Incorporated By Reference Herein: Registrant s Definitive Proxy Statement for its Annual Meeting of Stockholders, which will be filed within 120 days of the fiscal year ended December 31, 2005, is incorporated by reference into Part III of this report.

HANMI FINANCIAL CORPORATION

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

Some of the statements under Item 1. Business, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, expects, plans, intends, anticipates, believes, estimates, predicts, potential, or continue, or terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ from those expressed or implied by the forward-looking statement. For a discussion of some of the factors that might cause such a difference, see Item 1A. Risk Factors.

PART I

ITEM 1. *BUSINESS*

General

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

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

Hanmi Bank is a community bank conducting general business banking, with its primary market encompassing the multi-ethnic population of Los Angeles, Orange, San Diego, San Francisco and Santa Clara counties. The Bank s full-service offices are located in business areas where many of the businesses are run by immigrants and other minority groups. The Bank s client base reflects the multi-ethnic composition of these communities. On April 30, 2004, we completed the acquisition of Pacific Union Bank (PUB), a $1.2 billion (assets) commercial bank headquartered in Los Angeles that also served primarily the Korean-American community. At December 31, 2005, the Bank had 22 full-service branch offices in California and four loan production offices in California, Illinois, Virginia and Washington.

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

	For the Years Ended December 31,					
	2005		2004		2003	
	(Dollars in thousands)					
Interest and Fees on Loans	$ 179,011	77.4%	$ 116,811	72.2%	$ 64,505	66.2%

Interest on Investments	18,507	8.0%	17,372	10.7%	12,410	12.7%
Other Interest Income	1,589	0.7%	183	0.1%	502	0.5%
Service Charges on Deposit Accounts	15,782	6.8%	14,441	8.9%	10,339	10.6%
Other Non-Interest Income	16,434	7.1%	12,958	8.1%	9,683	10.0%
Total Revenues	$ **231,323**	100.0%	$ **161,765**	100.0%	$ **97,439**	100.0%

1

Table of Contents

Business Combination

On April 30, 2004, we completed the acquisition of PUB and merged PUB with Hanmi Bank. We paid $164.5 million in cash to acquire 5,537,431 of the PUB shares owned by Korea Exchange Bank. All of the remaining PUB shares were converted in the acquisition into shares of Hanmi Financial s common stock based on an exchange ratio of 2.312 shares for each PUB share.

Immediately prior to the completion of the acquisition, we issued a total of 7,894,738 shares of our common stock pursuant to a private placement for total proceeds of $75,000,000 before expenses and placement fees. Because of the issuance of shares in the merger and the private placement, as well as normal stock option activity, the number of outstanding shares increased to 49,330,704 as of December 31, 2004.

In addition, all outstanding PUB employee stock options were converted into 137,414 options to purchase Hanmi Financial stock valued at $1.1 million in total. Based on Hanmi Financial s average price of $12.53 for the five-day trading period from April 28, 2004 through May 4, 2004, the total consideration paid for PUB was $324.7 million and resulted in the recognition of goodwill aggregating $207.2 million. Net assets acquired totaled $324.7 million.

The post-merger integration of PUB s operations was completed substantially as planned. During the third quarter of 2004, we successfully completed the conversion of PUB s core loan, deposits and general ledger data processing systems onto Hanmi Bank s platform. On October 4, 2004, the Bank closed four redundant branches, bringing the total number of branches to 23. On January 22, 2005, the Bank closed an additional branch, as planned, and completed its post-merger staff reduction program.

Following the acquisition of PUB, management initiated and approved plans to restructure the operations of the existing Bank and PUB branch networks and corporate headquarters to eliminate duplicative facilities, streamline operations and reduce costs. Through December 31, 2005, 54 employees had been terminated.

For further discussion of the financial effects of the merger, see Notes to Consolidated Financial Statements, Note 2 Business Combinations.

Market Area

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

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

Lending Activities

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

Table of Contents

Commercial Loans

Hanmi Bank offers commercial loans for intermediate and short-term credit. Commercial loans may be unsecured, partially secured or fully secured. The majority of the origination of commercial loans is in Los Angeles and Orange Counties, and loan maturities are normally 12 to 60 months. Hanmi Bank requires a complete credit underwriting before considering any extension of credit. The Bank finances primarily small and middle market businesses in a wide spectrum of industries. Short-term business loans generally are intended to finance current operations and typically provide for periodic principal payments, with interest payable monthly. Term loans normally provide for floating interest rates, with monthly payments of both principal and interest.

In general, it is the intent of Hanmi Bank to take collateral whenever possible, regardless of the loan purpose(s). Collateral may include liens on inventory, accounts receivable, fixtures and equipment, leasehold improvements and real estate. When real estate is the primary collateral, the Bank obtains formal appraisals in accordance with applicable regulations to support the value of the real estate collateral. As a matter of policy, Hanmi Bank requires all principals of a business to be co-obligors on all loan instruments and all significant stockholders of corporations to execute a specific debt guaranty. All borrowers must demonstrate the ability to service and repay not only Hanmi Bank debt, but also all outstanding business debt, without liquidating the collateral, based on historical earnings or reliable projections.

Commercial and industrial loans consist of credit lines for operating needs, loans for equipment purchases and working capital, and various other business purposes.

As compared to consumer lending, commercial lending entails significant additional risks. These loans typically involve larger loan balances and are generally dependent on the business s cash flow and, thus, may be subject to adverse conditions in the general economy or in a specific industry.

Small Business Administration Guaranteed Loans

Hanmi Bank originates loans qualifying for guarantees issued by the United States SBA, an independent agency of the Federal government. The SBA guarantees on such loans currently range from 75 percent to 85 percent of the principal and accrued interest. Under certain circumstances, the guarantee of principal and interest may be less than 75 percent. In general, the guaranteed percentage is less than 75 percent for loans over $1.3 million. Hanmi Bank typically requires that SBA loans be secured by business assets and by a first or second deed of trust on any available real property. When the loan is secured by a first deed of trust on real property, the Bank obtains appraisals in accordance with applicable regulations. SBA loans have terms ranging from 7 to 25 years depending on the use of the proceeds. To qualify for a SBA loan, a borrower must demonstrate the capacity to service and repay the loan, without liquidating the collateral, on the basis of historical earnings or reliable projections.

Hanmi Bank generally sells to unrelated third parties a substantial amount of the guaranteed portion of the SBA guaranteed loans that it originates. When Hanmi Bank sells a SBA loan, it may be obligated to repurchase the loan (for a period of 90 days after the sale) if the loan fails to comply with certain representations and warranties given by the Bank. The Bank is also obligated to repurchase the loan (before 120 days past due) if the loan is past due. Hanmi Bank retains the obligation to service the SBA loans, for which it receives servicing fees. The unsold portions of the SBA loans that remain owned by Hanmi Bank are included in Loans Receivable. As of December 31, 2005, Hanmi Bank had $155.5 million in SBA loans on its balance sheet, and was servicing $183.4 million of sold SBA loans.

Loans Secured by Real Estate

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

Table of Contents

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

Hanmi Bank s commercial real estate loans are principally secured by investor-owned commercial buildings and owner-occupied commercial and industrial buildings. Generally, these types of loans are made for a period of up to seven years, with monthly payments based upon a portion of the principal plus interest, and with a loan-to-value ratio of 65 percent or less, using an adjustable rate indexed to the prime rate appearing in the West Coast edition of *The Wall Street Journal* (WSJ Prime Rate) or Hanmi Bank s prime rate (Bank Prime Rate), as adjusted from time to time. Hanmi Bank also offers fixed-rate loans, including hybrid-fixed rate loans that are fixed for one to five years and convert to adjustable rate loans for the remaining term. Amortization schedules for commercial loans generally do not exceed 25 years.

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

Real Estate Construction Loans Hanmi Bank finances the construction of residential, multifamily, commercial and industrial properties within its market area. The future condition of the local economy could negatively affect the collateral values of such loans. The Bank s construction loans typically have the following characteristics:

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

recourse against the borrower or a guarantor in the event of default.

Hanmi Bank does not typically commit to making permanent loans on the property unless the permanent loan is a government guaranteed loan. Construction loans involve additional risks compared to loans secured by existing improved real property. These include the following:

the uncertain value of the project prior to completion;

the inherent uncertainty in estimating construction costs, which are often beyond the borrower s control;

construction delays and cost overruns;

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

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

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

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

Consumer Loans

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

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

Off-Balance Sheet Commitments

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

Table of Contents

Lending Procedures and Loan Approval Process

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

At December 31, 2005, Hanmi Bank s authorized legal lending limits were $47.7 million for unsecured loans plus an additional $31.8 million for specific secured loans. Legal lending limits are calculated in conformance with California law, which prohibits a bank from lending to any one individual or entity or its related interests an aggregate amount that exceeds 15 percent of primary capital plus the allowance for loan losses on an unsecured basis, plus an additional 10 percent on a secured basis. Hanmi Bank s primary capital plus allowance for loan losses at December 31, 2005 totaled $318.1 million.

The highest management lending authority at Hanmi Bank is the combined administrative lending authority for unsecured lending of $3.0 million and secured lending of $5.0 million, which requires the approval and signatures of the Management Credit Committee, composed of the Chief Executive Officer, the Chief Credit Officer, the Deputy Chief Credit Officer, the Manager of the Capital Markets Group and the Credit Administrator. The next highest lending authority is $1.0 million for the Chief Credit Officer and Deputy Chief Credit Officer. All other individual lending authority is substantially less.

Lending limits are authorized for the Management Credit Committee, the Chief Credit Officer and other officers by the Bank s Board of Directors Loan Committee. The Chief Credit Officer is responsible for evaluating the authority limits for individual credit officers and recommending lending limits for all other officers to the Board of Directors for approval.

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

Asset Quality

Non-Performing Assets Non-performing assets include non-performing loans and other real estate owned.

Non-Performing Loans Non-performing loans are those that are not earning income, and (1) full payment of principal and interest is no longer anticipated, (2) principal or interest is 90 days or more delinquent, or (3) the loan payment or term has been restructured in accordance with troubled debt restructure procedures.

Non-Accrual Loans Hanmi Bank generally places loans on non-accrual status when interest or principal payments become 90 days or more past due unless the outstanding principal and interest is adequately secured and, in the opinion of management, is deemed to be in the process of collection. When loans are placed on non-accrual status, accrued but unpaid interest is reversed against the current year s income, and interest income on non-accrual loans is recorded on a cash basis. The Bank may treat payments as interest income or return of principal depending upon management s opinion of the ultimate risk of loss on the individual loan. Cash payments are treated as interest income where management believes the remaining principal balance is fully collectible. Additionally, the Bank may place loans that are not 90 days past due on non-accrual status, if management reasonably believes the borrower will not be able to comply with the contractual loan repayment terms and collection of principal or interest is in question.

Table of Contents

Loans 90 Days or More Past Due Hanmi Bank classifies a loan in this category when the borrower is more than 90 days late in making a payment of principal or interest.

Restructured Loans These are loans on which interest accrues at a below market rate or upon which a portion of the principal has been forgiven so as to aid the borrower in the final repayment of the loan, with any interest previously accrued, but not yet collected, being reversed against the current year s income. Generally, interest is reported on a cash basis until the borrower s ability to service the restructured loan in accordance with its terms is established.

Other Real Estate Owned (OREO) This category of non-performing assets consists of real estate to which the Bank has taken title by foreclosure or by taking a deed in lieu of foreclosure from the borrower. Before the Bank takes title to OREO, it generally obtains an environmental review.

Substandard and Doubtful Loans Hanmi Bank monitors all loans in the loan portfolio to identify problem credits. Additionally, as an integral part of the credit review process, credit reviews are performed by inside loan review officers throughout the year to assure accuracy of documentation and the identification of problem credits. The DFI and the Federal Reserve Bank of San Francisco (FRB) also review Hanmi Bank and its loans during annual safety and soundness examinations.

Hanmi Bank has three classifications for problem loans:

Substandard An asset is classified as substandard if it is inadequately protected by the current net worth and paying capacity of the borrower, or by the collateral pledged, if any. Credits in this category have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that Hanmi Bank will sustain some loss if the deficiencies are not corrected.

Doubtful An asset is classified as doubtful if it has all the weaknesses inherent in an asset classified substandard, and has the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of important and reasonably specific pending factors that may work to the advantage and strengthening of the asset, its classification as an estimated loss is deferred until its more exact status may be determined.

Loss An asset is classified as a loss if it is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Any potential recovery is considered too small and/or the realization too distant in the future to justify retention as an asset on the Bank s books.

Another category, designated as special mention, is maintained for loans that do not currently expose Hanmi Bank to so significant a degree of risk as to warrant classification as substandard, doubtful or loss, but do possess credit deficiencies or potential weaknesses deserving management s close attention.

Impaired Loans Hanmi Bank defines impaired loans, regardless of past-due status, as those on which principal and interest are not expected to be collected under the original contractual repayment terms and/or loans that are troubled debt restructurings. Hanmi Bank charges off an impaired loan at the time management believes that the collection process has been exhausted. Hanmi Bank measures impaired loans based on the present value of future cash flows discounted at the loan s effective rate, and the loan s observable market price or the fair value of collateral if the loan is collateral-dependent. At December 31, 2005, $10.8 million of loans were impaired, $10.1 million of which were also on non-accrual status. The allowance for loan losses related to impaired loans was $5.0 million at December 31, 2005.

Except as disclosed above, as of December 31, 2005, management was not aware of any material credit problems of borrowers that would cause it to have serious doubts about the ability of a borrower to comply with the present loan repayment terms. However, no assurance can be given that there are no current credit problems that have not been brought to the attention of management. See Allowance for Loan Losses, Allowance for Off-Balance Sheet Items and Provision for Credit Losses.

Table of Contents

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

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

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

The Bank s Chief Credit Officer reports monthly to the Bank s Board of Directors and continuously reviews loan quality and loan classifications. These reports assist the Board in reviewing the levels of the allowance for loan losses and allowance for off-balance sheet items on a quarterly basis.

Deposits

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

Website

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

Employees

As of December 31, 2005, we had 552 full-time equivalent employees. Our employees are not represented by a union or covered by a collective bargaining agreement.

Insurance

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

Competition

The banking and financial services industry in California generally, and in Hanmi Bank s market areas specifically, are highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, new competitors in the market, and the pace of consolidation among financial service providers. Hanmi Bank competes for loans, deposits and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, real estate investment trusts, insurance companies, finance companies, money market funds, credit unions and other non-bank financial service providers. Some of these competitors are larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than does the Bank. In addition, recent Federal legislation may have the effect of further increasing the pace of consolidation within the financial services industry. See Supervision and Regulation.

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

Banks generally, and Hanmi Bank in particular, face increasing competition for loans and deposits from non-bank financial intermediaries including credit unions, savings and loan associations, brokerage firms, thrift and loan companies, mortgage companies, real estate investment trusts, insurance companies and other financial and non-financial institutions. In addition, there is increased competition among banks, savings and loan institutions, and credit unions for the deposit and loan business of individuals.

The recent trend has been for other institutions, including brokerage firms, credit card companies and retail establishments, to offer banking services to consumers, including money market funds with check access and cash advances on credit card accounts. In addition, other entities (both public and private) seeking to raise capital through the issuance and sale of debt or equity securities compete with banks in the acquisition of deposits. While the direction of recent legislation and economic developments seems to favor increased competition between different types of financial institutions for both deposits and loans, resulting in increased cost of funds to banks, it is not possible to predict the full impact these developments will have on commercial banking or Hanmi Bank.

Hanmi Bank s major competitors are relatively smaller community banks that focus their marketing efforts on Korean-American businesses in Hanmi Bank s service areas. Amongst these banks, Hanmi Bank is the largest, with a loan portfolio that is 71 percent larger than its nearest competitor s loan portfolio, and a deposit portfolio that is 85 percent larger than its nearest competitor s deposit portfolio. These banks compete for loans primarily through the interest rates and fees they charge and the convenience and quality of service they provide to borrowers. The principal bases of competition for deposits are the interest rate paid, convenience and service.

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

Economic Conditions, Government Policies, Legislation and Regulation

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

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

From time to time, legislation is enacted which has the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers, such as recent federal legislation permitting affiliations among commercial banks, insurance companies and securities firms. We cannot predict whether any potential legislation will be enacted, and if enacted, the effect that it, or any implementing regulations, would have on our financial condition or results of operations. See Supervision and Regulation.

Table of Contents

Supervision and Regulation

General We are extensively regulated under both Federal and state law. This regulation is intended primarily for the protection of depositors and the deposit insurance fund and not for the benefit of stockholders of the financial institution. Set forth below is a summary description of the material laws and regulations that relate to our operations. The description is qualified in its entirety by reference to the applicable laws and regulations.

Hanmi Financial As a financial holding company, we are subject to regulation and examination by the FRB under the Bank Holding Company Act of 1956, as amended (the BHCA). We are required to file with the FRB periodic reports and such additional information as the FRB may require. The FRB bank holding company rating system emphasizes risk management and evaluation of the potential impact of non-depository entities on safety and soundness.

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

We are required to obtain prior FRB approval for the acquisition of more than five percent of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior FRB approval is also required for the merger or consolidation of the company and another bank holding company.

We are prohibited by the BHCA, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than five percent of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to our subsidiaries. However, subject to the prior FRB approval, we may engage in any, or acquire shares of companies engaged in, activities that the FRB deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. We may also engage in these and certain other activities pursuant to our election as a financial holding company.

It is the policy of the FRB that each bank holding company serve as a source of financial and managerial strength to its subsidiary bank(s) and it may not conduct operations in an unsafe or unsound manner. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of FRB regulations or both.

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

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

- lending, exchanging, transferring, investing for others, or safeguarding financial assets other than money or securities;

- providing any device or other instrumentality for transferring money or other financial assets;

arranging, effecting or facilitating financial transactions for the account of third parties;

securities underwriting;

dealing and market making;

sponsoring mutual funds and investment companies;

insurance underwriting and agency sales;

merchant banking investments; and

activities that the FRB, in consultation with the Secretary of the Treasury, determines from time to time to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

In order to elect or retain financial holding company status, all of our depository institution subsidiaries must be well capitalized, well managed, and, except in limited circumstances, in satisfactory compliance with the Community Reinvestment Act. Failure to sustain compliance with these requirements or correct any non-compliance within a fixed time period could lead to divestiture of subsidiary banks or require us to conform all of our activities to those permissible for a bank holding company. A bank holding company that is not also a financial holding company can only engage in banking and such other activities determined by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The Bank As a California chartered bank which is a member of the Federal Reserve, we are subject to primary supervision, periodic examination, and regulation by the DFI and the Federal Reserve Board (the FRB), as well as certain regulations promulgated by the Federal Deposit Insurance Corporation (the FDIC). If, as a result of an examination of the Bank, the FRB or DFI determines that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of our operations are unsatisfactory or that we are violating or have violated any law or regulation, various remedies are available to the FRB, including the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict our growth, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate our deposit insurance, which would result in a revocation of the Bank s charter. See Safety and Soundness Standards.

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

Any changes in Federal or state banking laws or the regulations of the banking agencies could have a material adverse impact on us, the Bank and our operations. For example, in January, 2006, the Federal banking agencies jointly issued proposed guidance for banks and thrifts with high and increasing concentrations of commercial real estate (CRE) construction and development loans. The implementation of these guidelines in final form could result in increased reserves and capital costs for banks and thrifts with CRE concentration. The Bank s CRE portfolio as of December 31, 2005 would not meet the definition of CRE concentration as set forth in the proposed guidelines.

Because California permits commercial banks chartered by the state to engage in any activity permissible for national banks, the Bank can form subsidiaries to engage in the many so-called closely related to banking or non-banking activities commonly conducted by national banks in operating subsidiaries, but also expanded financial activities to the same extent as a national bank. However, in order to form a financial subsidiary, the Bank must be well-capitalized and would be subject to the same capital deduction, risk management and affiliate transaction rules as applicable to national banks. Generally, a financial subsidiary is permitted to engage in activities that are financial in nature or incidental thereto, even though they are not permissible for the national bank to conduct directly within the bank. The definition of financial in nature includes, among other items, underwriting, dealing in or making a market in securities, including, for example, distributing shares of mutual funds. The subsidiary may not, however, engage as principal in underwriting insurance (other than credit life insurance), issue annuities or engage in real estate development or investment or merchant banking.

Federal Home Loan Bank System The Bank is a member of the Federal Home Loan Bank of San Francisco (FHLB). Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As a FHLB member, we are required to own a certain amount of capital stock in the FHLB. At December 31, 2005, we were in compliance with the stock requirements.

Interstate Banking and Branching Banks have the ability, subject to certain state restrictions, to acquire by acquisition or merger branches outside their home states. The establishment of new interstate branches is also

Table of Contents

possible in those states with laws that expressly permit it. Interstate branches are subject to certain laws of the states in which they are located. Competition may increase further as banks branch across state lines and enter new markets.

The Sarbanes-Oxley Act of 2002 The Sarbanes-Oxley Act of 2002 addresses accounting oversight and corporate governance matters, including:

- required executive certification of financial presentations;
- increased requirements for board audit committees and their members;
- enhanced disclosure of controls and procedures and internal control over financial reporting;
- enhanced controls on, and reporting of, insider trading;
- increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances; and
- the prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years.

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

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

The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends. Under such restrictions, the amount available for payment of dividends to Hanmi Financial by the Bank totaled $95.4 million at December 31, 2005. In addition, the Bank s regulators have the authority to prohibit the Bank from paying dividends, depending upon the Bank s financial condition, if such payment is deemed to constitute an unsafe or unsound practice.

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

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

The risk-based capital guidelines require a minimum ratio of qualifying total capital to risk-adjusted assets of 8 percent and a minimum ratio of Tier 1 capital to risk-adjusted assets of 4 percent. In addition to the risk-based guidelines, Federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 3 percent.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FDIC to ensure the maintenance of required capital levels. As discussed above, we are required to maintain certain levels of capital, as is the bank. The regulatory capital guidelines as well as our actual capitalization on a consolidated basis and for the Bank as of December 31, 2005 follow:

	Requirement			
	Adequately Capitalized	**Well Capitalized**	**Bank**	**Holding Company**
Total Risk-Based Capital Ratio	8.0%	10.0%	11.98%	12.04%
Tier 1 Risk-Based Capital Ratio	4.0%	6.0%	10.96%	11.03%
Tier 1 Leverage Capital Ratio	4.0%	5.0%	9.06%	9.11%

The risk-based capital guidelines are based upon the 1988 capital accord of the international Basel Committee on Banking Supervision. A new international accord, referred to as Basel II, which emphasizes internal assessment of credit, market and operational risk; supervisory assessment and market discipline in determining minimum capital requirements, currently becomes mandatory in 2008 only for banks with over $250 billion in assets or total on-balance-sheet foreign exposure of $10 billion or more. Alternative capital requirements are under consideration by the U.S. Federal banking agencies for smaller U.S. banks which may be negatively impacted competitively by certain provisions of Basel II.

Prompt Corrective Action Federal banking agencies possess broad powers to take corrective and other supervisory action to resolve the problems of insured depository institutions, including but not limited to those institutions that fall within any undercapitalized category. Each Federal banking agency has promulgated regulations defining the following five categories in which an insured depository institution will be placed, based on its capital ratios:

- well capitalized;
- adequately capitalized;
- undercapitalized;
- significantly undercapitalized; and
- critically undercapitalized.

The regulations use an institution s risk-based capital, leverage capital and tangible capital ratios to determine the institution s capital classification. An institution is treated as well capitalized if its total capital to risk-weighted assets ratio is 10.00 percent or more; its core capital to risk-weighted assets ratio is 6.00 percent or more; and its core capital to adjusted total assets ratio is 5.00 percent or more. At December 31, 2005, the Bank and Hanmi Financial had capital ratios that exceeded the required ratios for classification as well-capitalized.

An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate Federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or unsound practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions. The Federal banking agencies, however, may not treat a significantly undercapitalized institution as critically undercapitalized unless its capital ratio actually warrants such treatment.

Safety and Soundness Standards In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the Federal regulators and/or state regulations for state banks, for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, or any condition imposed in writing by the agency or any written agreement with the agency. Further, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized without the express permission of the institution s primary regulator.

The Federal banking agencies have adopted guidelines designed to assist the Federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems, (ii) loan documentation, (iii) credit underwriting, (iv) asset growth, (v) earnings, and (vi) compensation, fees and benefits. In addition, the Federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets, (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses, (iii) compare problem asset totals to capital, (iv) take appropriate corrective action to resolve problem assets, (v) consider the size and potential risks of material asset concentrations, and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

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

The assessment rate currently ranges from zero to 27 cents per $100 of domestic deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. Due principally to continued growth in deposits, the BIF is nearing its minimum ratio of 1.25 percent of insured deposits as mandated by law. If the ratio drops below 1.25 percent, it is likely the FDIC will be required to assess premiums on all banks. Any increase in assessments or the assessment rate could have a material adverse effect on earnings, depending on the amount of the increase. Furthermore, the FDIC is authorized to raise insurance premiums under certain circumstances.

The FDIC is authorized to terminate a depository institution s deposit insurance upon a finding by the FDIC that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the institution s regulatory agency. The termination of deposit insurance for one or more of the company s subsidiary depository institutions could have a material adverse effect on the company s earnings, depending on the collective size of the particular institutions involved.

All FDIC-insured depository institutions must pay an annual assessment to provide funds for the payment of interest on bonds issued by the Financing Corporation, a Federal corporation chartered under the authority of the Federal Housing Finance Board. The bonds, commonly referred to as FICO bonds, were issued to capitalize the Federal

Savings and Loan Insurance Corporation. The FICO assessment rate for the fourth quarter of fiscal 2005 was 1.34 basis points for each $100 of assessable deposits. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC s insurance funds and do not vary depending on a depository institution s capitalization or supervisory evaluations.

The enactment in February 2006, of the Federal Deposit Insurance Reform Act of 2006, or FDIRA, provides, among other things, for the merger of the BIF and the SAIF into the Deposit Insurance Fund; future inflation

Table of Contents

adjustment increases in the standard maximum deposit insurance amount of $100,000; the increase of retirement account coverage to $250,000; changes in the formula and factors to be considered by the FDIC in calculating the FDIC reserve ratio, assessments and dividends, and a one-time aggregate assessment credit for depository institutions in existence on December 31, 1996 (or their successors) which paid assessments to recapitalize the insurance funds after the banking crises of the late 1980s and early 1990s. The FDIC is to issue regulations implementing the provisions of FDIRA. At this time it is uncertain what effect FDIRA and the forthcoming regulations will have on the Bank.

Loans-to-One Borrower Limitations With certain limited exceptions, the maximum amount of obligations, secured and unsecured, that any borrower (including certain related entities) may owe to a California state bank at any one time may not exceed 25 percent of the sum of the shareholders equity, allowance for loan losses, capital notes and debentures of the bank. Unsecured obligations may not exceed 15 percent of the sum of the shareholders equity, allowance for loan losses, capital notes and debentures of the bank.

Extensions of Credit to Insiders and Transactions with Affiliates The Federal Reserve Act and FRB Regulation O place limitations and conditions on loans or extensions of credit to:

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

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

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

USA PATRIOT Act The USA PATRIOT Act of 2001 and its implementing regulations significantly expanded the anti-money laundering and financial transparency laws. Under the USA PATRIOT Act, financial institutions are subject to prohibitions regarding specified financial transactions and account relationships, as well as additional enhanced due diligence and know your customer standards in their dealings with foreign financial institutions, foreign customers and private banking customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are required to establish and maintain anti-money laundering programs which include:

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

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

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

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

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

engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

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

Table of Contents

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

initial notices to customers about their privacy policies, describing the conditions under which they may disclose non-public personal information to non-affiliated third parties and affiliates;

annual notices of their privacy policies to current customers; and

a reasonable method for customers to opt out of disclosures to non-affiliated third parties.

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

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

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

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

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

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

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

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

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

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

Due to heightened regulatory concern related to compliance with HOEPA, FACT, ECOA, TILA, FH Act, CRA, HMDA and RESPA generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in its local community.

ITEM 1A. *RISK FACTORS*

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

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

Our concentrations in commercial real estate loans located primarily in Southern California could have adverse effects on credit quality. Approximately 35.5 percent of the Bank s loan portfolio consists of commercial real estate and construction loans, primarily in Southern California. As a result of this concentration, a deterioration of the Southern California commercial real estate market could have adverse consequences for the Bank. Among the factors that could contribute to such a decline are general economic conditions in Southern California, interest rates and local market construction and sales activity.

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

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

Competition may adversely affect our performance. The banking and financial services businesses in our market areas are highly competitive. We face competition in attracting deposits, in making loans and attracting and retaining employees. The increasingly competitive environment is a result of changes in

Table of Contents

regulation, changes in technology and product delivery systems, new competitors in the market, and the pace of consolidation among financial services providers. Our results in the future may differ depending upon the nature and level of competition.

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

ITEM 1B. *UNRESOLVED STAFF COMMENTS*

None.

ITEM 2. *PROPERTIES*

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

The following table sets forth information about our offices:

Office	Type of Office	Address		Owned/ Leased
Corporate Headquarters	Headquarters(1)(2)	3660 Wilshire Boulevard, Penthouse Suite A	Los Angeles, CA	Leased
Cerritos Branch	Branch	11754 East Artesia Boulevard	Artesia, CA	Leased
Downtown Branch	Branch	950 South Los Angeles Street	Los Angeles, CA	Leased
Fashion District Branch	Branch	726 East 12th Street, Suite 211	Los Angeles, CA	Leased
Garden Grove Branch	Branch	9820 Garden Grove Boulevard	Garden Grove, CA	Owned
Gardena Branch	Branch	2001 West Redondo Beach Boulevard	Gardena, CA	Leased
Irvine Branch	Branch	14474 Culver Drive, Suite D	Irvine, CA	Leased
Koreatown Galleria Branch	Branch	3250 West Olympic Boulevard, Suite 200	Los Angeles, CA	Leased
Koreatown Plaza Branch	Branch(3)	928 South Western Avenue, Suite 260	Los Angeles, CA	Leased
Mid-Olympic Branch	Branch(4)	3099 West Olympic Boulevard	Los Angeles, CA	Owned
Olympic Branch	Branch(5)		Los Angeles, CA	Owned

		3737 West Olympic Boulevard		
Rowland Heights Branch	Branch	18720 East Colima Road	Rowland Heights, CA	Leased
San Diego Branch	Branch	4637 Convoy Street, Suite 101	San Diego, CA	Leased
San Francisco Branch	Branch	1491 Webster Street	San Francisco, CA	Leased
Silicon Valley Branch	Branch	2765 El Camino Real	Santa Clara, CA	Leased
South Cerritos Branch	Branch	11900 South Street, Suite 109	Cerritos, CA	Leased
Torrance Branch	Branch	2370 Crenshaw Boulevard, Suite H	Torrance, CA	Leased
Van Nuys Branch	Branch	14427 Sherman Way	Van Nuys, CA	Leased
Vermont Branch	Branch(6)	933 South Vermont Avenue	Los Angeles, CA	Owned
West Garden Grove Branch	Branch	9122 Garden Grove Boulevard	Garden Grove, CA	Owned
West Torrance Branch	Branch	21838 Hawthorne Boulevard	Torrance, CA	Leased
Western Branch	Branch	120 South Western Avenue	Los Angeles, CA	Leased
Wilshire Branch	Main Branch(7)	3660 Wilshire Boulevard, Suite 103	Los Angeles, CA	Leased
Commercial Loan Department	Loan Office(1)	3660 Wilshire Boulevard, Suite 1050	Los Angeles, CA	Leased
SBA Loan Department	Loan Office(1)	3327 Wilshire Boulevard	Los Angeles, CA	Leased
Northern California LPO	Loan Office(1)	39899 Balentine Drive, Suite 200	Newark, CA	Leased
Seattle LPO	Loan Office(1)	33110 Pacific Highway South, Suite 4	Federal Way, WA	Leased
Chicago LPO	Loan Office(1)	6200 North Hiawatha, Suite 235	Chicago, IL	Leased
Virginia LPO	Loan Office(1)	7535 Little River Turnpike, Suite 200B	Annandale, VA	Leased

Table of Contents

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

(2) *Capital Markets Group is also located at this facility.*

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

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

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

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

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

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

ITEM 3. *LEGAL PROCEEDINGS*

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

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

During the fourth quarter of 2005, no matters were submitted to stockholders for a vote.

PART II

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

Market Price for Common Stock

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

	High	Low	Cash Dividend
2005:			
Fourth Quarter	$ 20.42	$ 16.51	$ 0.05 per share
Third Quarter	$ 19.72	$ 16.27	$ 0.05 per share
Second Quarter	$ 17.90	$ 14.05	$ 0.05 per share
First Quarter	$ 19.19	$ 15.62	$ 0.05 per share
2004:			
Fourth Quarter	$ 19.16	$ 14.70	$ 0.05 per share
Third Quarter	$ 16.70	$ 13.47	$ 0.05 per share

Second Quarter	$ 14.77	$ 11.64	$ 0.05 per share
First Quarter	$ 14.99	$ 9.75	$ 0.05 per share

Hanmi Financial had 367 registered stockholders of record as of February 28, 2006.

Dividends

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

The power of the board of directors of a state chartered bank, such as Hanmi Bank, to declare a cash dividend is limited by statutory and regulatory restrictions that restrict the amount available for cash dividends depending upon

Table of Contents

the earnings, financial condition and cash needs of the bank, as well as general business conditions. See Item 1. Business Dividends and Other Transfers of Funds.

On January 20, 2005, our Board of Directors declared a two-for-one stock split, to be effected in the form of a 100 percent common stock dividend. The new shares were distributed on February 15, 2005 to shareholders of record on the close of business on January 31, 2005.

ITEM 6. *SELECTED FINANCIAL DATA*

The following table presents selected historical financial information, including per share information as adjusted for the stock dividends and stock splits declared by us. This selected historical financial data should be read in conjunction with our consolidated financial statements and the notes thereto appearing elsewhere in this Report and the information contained in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and Item 1. Business Business Combination. The selected historical financial data as of and for each of the years in the five years ended December 31, 2005 is derived from our audited financial statements. In the opinion of management, the information presented reflects all adjustments, including normal and recurring accruals, considered necessary for a fair presentation of the results of such periods.

	As of and for the Year Ended December 31, (Dollars in thousands, except for per share data)				
	2005	**2004**	**2003**	**2002**	**2001**
SUMMARY STATEMENT OF INCOME DATA:					
Interest Income	$ 199,107	$ 134,366	$ 77,417	$ 69,316	$ 76,678
Interest Expense	62,111	32,617	20,796	21,345	32,990
Net Interest Income Before Provision for Credit Losses	136,966	101,749	56,621	47,971	43,688
Provision for Credit Losses	5,395	2,907	5,680	4,800	1,400
Non-Interest Income	32,216	27,399	20,022	21,204	17,253
Non-Interest Expenses	69,133	66,566	39,325	38,333	32,028
Income Before Income Taxes	94,684	59,675	31,638	26,042	27,513
Income Taxes	36,455	22,975	12,425	9,012	10,703
Net Income	**$ 58,229**	**$ 36,700**	**$ 19,213**	**$ 17,030**	**$ 16,810**
SUMMARY STATEMENT OF FINANCIAL CONDITION DATA:					
Cash and Cash Equivalents	$ 163,477	$ 127,164	$ 62,595	$ 122,772	$ 81,205
Total Securities	443,912	418,973	414,616	279,548	213,179
Loans Receivable, Net[(1)]	2,469,080	2,234,842	1,248,399	975,154	781,718
Total Assets	3,414,252	3,104,188	1,787,139	1,457,313	1,159,416
Total Deposits	2,826,114	2,528,807	1,445,835	1,283,979	1,042,353
Total Liabilities	2,987,475	2,704,278	1,647,672	1,332,845	1,054,543
Total Shareholders Equity	426,777	399,910	139,467	124,468	104,873
Tangible Equity	209,028	178,791	137,424	122,304	102,689

Average Net Loans	2,359,439	1,912,534	1,103,765	882,625	701,714
Average Securities	418,964	425,537	379,635	244,675	235,034
Average Interest-Earning Assets	2,871,564	2,387,412	1,538,820	1,222,050	1,029,046
Average Total Assets	3,249,190	2,670,701	1,623,214	1,308,885	1,100,182
Average Deposits	2,632,254	2,129,724	1,416,564	1,164,562	988,392
Average Interest-Bearing Liabilities	2,046,227	1,687,688	1,057,249	854,858	736,947
Average Shareholders Equity	417,813	293,313	132,369	112,927	95,740
Average Tangible Equity	198,527	143,262	130,252	110,762	93,427

Table of Contents

	As of and for the Year Ended December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands, except for per share data)				
PER SHARE DATA:					
Earnings Per Share Basic	$ 1.18	$ 0.87	$ 0.68	$ 0.62	$ 0.61
Earnings Per Share Diluted	$ 1.17	$ 0.84	$ 0.67	$ 0.60	$ 0.60
Book Value Per Share[(2)]	$ 8.77	$ 8.11	$ 4.92	$ 4.47	$ 3.83
Tangible Book Value Per Share[(3)]	$ 4.30	$ 3.62	$ 4.85	$ 4.39	$ 3.75
Cash Dividends Per Share	$ 0.20	$ 0.20	$ 0.20	$	$
Common Shares Outstanding	48,658,798	49,330,704	28,326,820	27,830,866	27,385,660
SELECTED PERFORMANCE RATIOS:					
Return on Average Assets[(4)]	1.79%	1.37%	1.18%	1.30%	1.53%
Return on Average Shareholders Equity[(5)]	13.94%	12.51%	14.51%	15.08%	17.56%
Return on Average Tangible Equity[(6)]	29.33%	25.62%	14.75%	15.38%	17.99%
Net Interest Spread[(7)]	3.89%	3.70%	3.06%	3.17%	2.97%
Net Interest Margin[(8)]	4.77%	4.26%	3.68%	3.93%	4.25%
Average Shareholders Equity to Average Total Assets	12.86%	10.98%	8.15%	8.63%	8.70%
Efficiency Ratio[(9)]	40.86%	51.54%	51.31%	55.41%	52.40%
Dividend Payout Ratio[(10)]	16.95%	22.99%	29.41%		

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

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

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

(4) *Net income divided by average total assets.*

(5) *Net income divided by average shareholders equity.*

(6) *Net income divided by average tangible equity.*

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

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

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

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

Table of Contents

	As of and for the Year Ended December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands, except for per share data)				
SELECTED CAPITAL RATIOS:					
Tier 1 Capital to Average Total Assets:					
Hanmi Financial	9.11%	8.93%	7.80%	8.50%	8.86%
Hanmi Bank	9.06%	8.78%	7.75%	8.34%	8.76%
Tier 1 Capital to Total Risk-Weighted Assets:					
Hanmi Financial	11.03%	10.93%	10.05%	11.01%	11.71%
Hanmi Bank	10.96%	10.75%	10.00%	10.81%	11.59%
Total Capital to Total Risk-Weighted Assets:					
Hanmi Financial	12.04%	11.98%	11.13%	12.14%	12.87%
Hanmi Bank	11.98%	11.80%	11.09%	11.94%	12.75%
SELECTED ASSET QUALITY RATIOS:					
Non-Performing Loans to Total Gross Loans[11]	0.41%	0.27%	0.68%	0.65%	0.63%
Non-Performing Assets to Total Assets[12]	0.30%	0.19%	0.48%	0.44%	0.43%
Net Loan Charge-Offs to Average Total Gross Loans	0.12%	0.19%	0.29%	0.28%	0.45%
Allowance for Loan Losses to Total Gross Loans	1.00%	1.00%	1.06%	1.14%	1.19%
Allowance for Loan Losses to Non-Performing Loans	246.40%	377.49%	154.13%	173.81%	188.12%

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

[12] *Non-performing assets consist of non-performing loans (see footnote (11) above) and other real estate owned.*

Non-GAAP Financial Measures

Return on Average Tangible Equity

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

Table of Contents

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

	Years Ended December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands)				
Average Shareholders Equity	$ 417,813	$ 293,313	$ 132,369	$ 112,927	$ 95,740
Less Average Goodwill and Core Deposit Intangible Assets	(219,286)	(150,051)	(2,117)	(2,165)	(2,313)
Average Tangible Equity	**$ 198,527**	**$ 143,262**	**$ 130,252**	**$ 110,762**	**$ 93,427**
Return on Average Shareholders Equity	13.94%	12.51%	14.51%	15.08%	17.56%
Effect of Average Goodwill and Core Deposit Intangible Assets	15.39%	13.11%	0.24%	0.30%	0.43%
Return on Average Tangible Equity	**29.33%**	**25.62%**	**14.75%**	**15.38%**	**17.99%**

Tangible Book Value Per Share

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

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

	December 31,				
	2005	2004	2003	2002	2001
	(Dollars in thousands)				
Total Shareholders Equity	$ 426,777	$ 399,910	$ 139,467	$ 124,468	$ 104,873
Less Goodwill and Core Deposit Intangible Assets	(217,749)	(221,119)	(2,043)	(2,164)	(2,184)
Tangible Equity	**$ 209,028**	**$ 178,791**	**$ 137,424**	**$ 122,304**	**$ 102,689**

Book Value Per Share	$	8.77	$	8.11	$	4.92	$	4.47	$	3.83
Effect of Goodwill and Core Deposit Intangible Assets		(4.47)		(4.49)		(0.07)		(0.08)		(0.08)
Tangible Book Value Per Share	**$**	**4.30**	**$**	**3.62**	**$**	**4.85**	**$**	**4.39**	**$**	**3.75**

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

This discussion presents management s analysis of the financial condition and results of operations as of and for the years ended December 31, 2005, 2004 and 2003. This discussion should be read in conjunction with our consolidated financial statements and the notes related thereto presented elsewhere in this Report.

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

Table of Contents

CRITICAL ACCOUNTING POLICIES

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

During the year ended December 31, 2004, in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS No. 141), the purchase of Pacific Union Bank (PUB) required significant estimates and assumptions. We engaged outside experts, including appraisers, to assist in estimating the fair values of certain assets acquired, particularly the loan portfolio, core deposit intangible asset and fixed assets. The Bank used market data regarding securities market prices and interest rates to estimate the fair values of financial assets, including the securities portfolio, deposits and borrowings. We also evaluated long-lived assets for impairment and recorded any necessary adjustments. In accordance with Emerging Issues Task Force Issue No. 95-3, *Recognition of Liabilities in Connection With a Purchase Business Combination,* we recognized liabilities assumed for costs to involuntarily terminate employees of PUB and costs to exit activities of PUB under an exit plan approved by Hanmi Bank s Board of Directors.

We believe the allowance for loan losses and allowance for off-balance sheet items are critical accounting policies that require significant estimates and assumptions that are particularly susceptible to significant change in the preparation of our financial statements. See Financial Condition Allowance for Loan Losses and Allowance for Off-Balance Sheet Items, Results of Operations Provision for Credit Losses and Notes to Consolidated Financial Statements, Note 1 Summary of Significant Accounting Policies for a description of the methodology used to determine the allowance for loan losses and allowance for off-balance sheet items.

OVERVIEW

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

Over the last two years, we have experienced significant growth in assets and deposits. Total assets increased to $3,414.3 million at December 31, 2005 from $3,104.2 million and $1,787.1 million at December 31, 2004 and 2003, respectively. Net loans increased to $2,469.1 million at December 31, 2005 from $2,234.8 million and $1,248.4 million at December 31, 2004 and 2003, respectively. Total deposits increased to $2,826.1 million at December 31, 2005 from $2,528.8 million and $1,445.8 million at December 31, 2004 and 2003, respectively. Our asset growth was mainly due to the acquisition of PUB, which had assets of $1.2 billion, and also was attributable to loan production during the period.

For the year ended December 31, 2005, net income was $58.2 million, representing an increase of $21.5 million, or 58.7 percent, from $36.7 million for the year ended December 31, 2004. This resulted in basic earnings per share of $1.18 and $0.87 for the years ended December 31, 2005 and 2004, respectively, and diluted earnings per share of $1.17 and $0.84 for the same years. Our primary source of revenue is net interest income, which is the difference between interest and fees derived from earning assets and interest paid on liabilities incurred to fund those assets. Net interest income is affected by changes in the volume of interest-earning assets and interest-bearing liabilities. It also is affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing liabilities. The increase in net income for 2005 was attributable to increases in net interest margin and average interest-earning assets. Net interest income increased due to a 23.2 percent increase in volume of gross loans. The average interest rate paid on interest-bearing liabilities increased by 111 basis points while the average interest rate earned on interest-earning assets increased by 130 basis points. As a result, net interest spread increased by 19 basis points from 3.70 percent in 2004 to 3.89 percent in 2005.

For the year ended December 31, 2004, net income was $36.7 million, representing an increase of $17.5 million, or 91.0 percent, from $19.2 million for the year ended December 31, 2003. This resulted in basic earnings per share of $0.87 and $0.68 for the years ended December 31, 2004 and 2003, respectively, and diluted earnings per share of $0.84 and $0.67 for the same years. The increase in net income for 2004 was attributable to increases in net interest margin and average interest-earning assets. Net interest income increased due to a 73.1 percent increase in volume of gross loans. The average interest rate paid on interest-bearing liabilities decreased by four basis points while the average interest rate earned increased by 60 basis points. As a result, net interest spread increased by 64 basis points from 3.06 percent in 2003 to 3.70 percent in 2004.

Our results of operations are significantly affected by the provision for credit losses. The provision for credit losses was $5.4 million, $2.9 million and $5.7 million in 2005, 2004 and 2003, respectively, reflecting changes in the balance and credit quality of the loan portfolio.

We also generated substantial non-interest income from service charges on deposit accounts, charges and fees from international trade finance, and gains on sales of loans. For the year ended December 31, 2005, non-interest income was $32.2 million, an increase of $4.8 million, or 17.6 percent, over 2004 non-interest income of $27.4 million. For the year ended December 31, 2004, non-interest income was $27.4 million, an increase of $7.4 million, or 36.8 percent, over 2003 non-interest income of $20.0 million. The increases in both years resulted primarily from the merger with PUB and expansion in the Bank s loan and deposit portfolios.

Non-interest expenses consist primarily of employee compensation and benefits, occupancy and equipment expenses and data processing expenses. For the year ended December 31, 2005, non-interest expenses were $69.1 million, an increase of $2.6 million, or 3.9 percent, over 2004 non-interest expenses of $66.6 million. For the year ended December 31, 2004, non-interest expenses were $66.6 million, an increase of $27.3 million, or 69.3 percent, over 2003 non-interest expenses of $39.3 million. In both years, the increases were primarily the result of the merger with PUB. The efficiency ratio improved to 40.86 percent in 2005 compared to 51.54 percent in 2004 as the Bank achieved greater operating efficiencies after completing the integration of PUB s operations into the Bank s, whereas 2004 non-interest expenses included the cost of parallel operations and non-recurring expenses associated with the merger. In 2004, the efficiency ratio increased slightly to 51.54 percent compared to 51.31 percent in 2003 because of non-recurring expenses associated with the merger.

RESULTS OF OPERATIONS

Net Interest Income and Net Interest Margin

Our earnings depend largely upon the difference between the interest income received from our loan portfolio and other interest-earning assets and the interest paid on deposits and borrowings. The difference is net interest income. The difference between the yield earned on interest-earning assets and the cost of interest-bearing liabilities is net interest spread. Net interest income, when expressed as a percentage of average total interest-earning assets, is referred to as the net interest margin. Net interest income is affected by the change in the level and mix of interest-earning assets and interest-bearing liabilities, referred to as volume changes. Our net interest income also is affected by changes in the yields earned on assets and rates paid on liabilities, referred to as rate changes. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and competitive factors. Those factors are, in turn, affected by general economic conditions and other factors beyond our control, such as Federal economic policies, the general supply of money in the economy, income tax policies, governmental budgetary matters and the actions of the Fed.

For the years ended December 31, 2005 and 2004, net interest income was $137.0 million and $101.7 million, respectively. The net interest spread and net interest margin for the year ended December 31, 2005 were 3.89 percent and 4.77 percent, respectively, compared to 3.70 percent and 4.26 percent, respectively, for the year ended December 31, 2004.

For the years ended December 31, 2004 and 2003, net interest income was $101.7 million and $56.6 million, respectively. The net interest spread and net interest margin for the year ended December 31, 2004 were 3.70 percent and 4.26 percent, respectively, compared to 3.06 percent and 3.68 percent, respectively, for the year ended December 31, 2003.

Average interest-earning assets increased 20.3 percent to $2,871.6 million in 2005 from $2,387.4 million in 2004. Average gross loans increased 23.2 percent to $2,382.2 million in 2005 from $1,933.8 million in 2004, and average investment securities decreased 1.5 percent to $419.0 million in 2005 from $425.5 million in 2004. Total loan interest income increased by 53.2 percent in 2005 on an annual basis due to the increase in average gross loans outstanding and the increase in the average yield on loans from 6.04 percent in 2004 to 7.51 percent in 2005. The average interest rate charged on loans increased 147 basis points, reflecting the increase in the WSJ Prime Rate of 185 basis points from 4.34 percent in 2004 to 6.19 percent in 2005. The yield on average interest-earning assets increased from 5.63 percent in 2004 to 6.93 percent in 2005, an increase of 130 basis points, reflecting a shift in the mix of interest-earning assets from 81.0 percent loans, 17.8 percent securities and 1.2 percent other interest-earning assets in 2004 to 83.0 percent loans, 14.6 percent securities and 2.4 percent other interest-earning assets in 2005.

The majority of interest-earning assets growth was funded by a $502.5 million, or 23.6 percent, increase in average total deposits. Total average interest-bearing liabilities grew by 21.2 percent to $2,046.2 million in 2005 compared to $1,687.7 million in 2004. The average interest rate paid for interest-bearing liabilities increased by 111 basis points from 1.93 percent in 2004 to 3.04 percent in 2005 due to competitive pricing. As a result of the increases in the yield on interest-earning assets and cost of interest-bearing liabilities, the net interest spread increased to 3.89 percent in 2005 compared to 3.70 percent in 2004.

The 2005 net interest spread reflects the increase in the average balance of Federal funds sold, which are highly liquid but have a relatively low yield, from $12.8 million in 2004 to $46.8 million in 2005. The average yield on Federal funds sold was 3.40 percent and 1.43 percent in 2005 and 2004, respectively. In the second half of 2005, the Bank increased its rates on certificates of deposit to maintain relationships with valued customers and fund loan growth. In 2005, loan production increased 32.2 percent over 2004 levels. This trend was particularly evident in the second quarter of 2005 and continued throughout the second half of the year, during which production was 37.4 percent higher than 2004 levels. However, because of the flat yield curve (long-term interest rates were unusually low relative to short-term rates, approaching and briefly falling below short-term rates) and strong competition, the Bank experienced a high level of loan payoffs because management elected not to match the aggressive pricing on five- to seven-year fixed-rate loans offered to our customers by certain competitors.

Average interest-earning assets increased 55.1 percent to $2,387.4 million in 2004 from $1,538.8 million in 2003. Average gross loans increased 73.1 percent to $1,933.8 million in 2004 from $1,117.0 million in 2003 and average investment securities increased 12.1 percent to $425.5 million in 2004 from $379.6 million in 2003. Total loan interest income increased by 81.1 percent in 2004 on an annual basis due to the increase in average gross loans outstanding and the increase in average yield on loans from 5.78 percent in 2003 to 6.04 percent in 2004. The average interest rate charged on loans increased 26 basis points, reflecting the average WSJ Prime Rate increase of 22 basis points from 4.12 percent in 2003 to 4.34 percent in 2004. The yield on average interest-earning assets increased from 5.03 percent in 2003 to 5.63 percent in 2004, an increase of 60 basis points, reflecting a shift in the mix of interest-earning assets from 72.3 percent loans, 24.9 percent securities and 2.8 percent other interest-earning assets in 2003 to 81.0 percent loans, 17.8 percent securities and 1.2 percent other interest-earning assets in 2004.

The majority of interest-earning assets growth was funded by a $713.2 million, or 50.3 percent, increase in average total deposits. Total average interest-bearing liabilities grew by 59.6 percent to $1,687.7 million in 2004 compared to $1,057.2 million in 2003. The average interest rate paid for interest-bearing liabilities decreased by four basis points from 1.97 percent in 2003 to 1.93 percent in 2004. As a result of the increases in the yield on interest-earning assets and cost of interest-bearing liabilities, the net interest spread increased to 3.74 percent in 2004 compared to 3.09 percent in 2003.

Table of Contents

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

	For the Year Ended December 31,							
	2005			2004			2003	
	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense	Average Yield/ Rate	Average Balance	Interest Income/ Expense
	(Dollars in thousands)							
rning Assets:								
ns, Net[1]	$ 2,382,230	$ 179,011	7.51%	$ 1,933,761	$ 116,811	6.04%	$ 1,116,952	$ 64,505
Securities[2]	74,166	3,122	6.48%	70,372	3,015	6.59%	33,596	1,421
s of Other U.S. nt Agencies	102,703	4,002	3.90%	90,336	3,374	3.73%	70,465	2,395
: Securities	241,881	10,271	4.25%	264,829	10,261	3.87%	275,574	8,321
urities	23,571	1,107	4.70%	15,041	716	4.76%	6,003	273
nds Sold	46,799	1,589	3.40%	12,772	183	1.43%	21,844	277
ral Funds Sold							14,370	225
rning Deposits	214	5	2.34%	301	6	1.99%	16	
est-Earning Assets	2,871,564	199,107	6.93%	2,387,412	134,366	5.63%	1,538,820	77,417
t-Earning Assets:								
Cash Equivalents	92,245			76,064			52,067	
for Loan Losses	(22,791)			(21,227)			(13,187)	
ets	308,172			228,452			45,514	
nterest-Earning	377,626			283,289			84,394	
ets	**$ 3,249,190**			**$ 2,670,701**			**$ 1,623,214**	
and Shareholders Equity								
earing Liabilities:								
rket Checking	$ 539,678	12,964	2.40%	$ 466,880	8,098	1.73%	$ 207,689	2,584
	138,167	2,130	1.54%	131,589	1,790	1.36%	97,070	1,894
osits of $100,000 or	959,904	31,984	3.33%	611,555	10,966	1.79%	386,701	7,415
e Deposits	242,996	7,114	2.93%	253,884	5,414	2.13%	302,651	7,354
owed Funds	165,482	7,919	4.79%	223,780	6,349	2.84%	63,138	1,549
est-Bearing Liabilities	2,046,227	62,111	3.04%	1,687,688	32,617	1.93%	1,057,249	20,796

t-Bearing Liabilities:						
eposits	751,509		665,816		422,453	
ilities	33,641		23,884		11,143	
nterest-Bearing	785,150		689,700		433,596	
ilities	2,831,377		2,377,388		1,490,845	
rs Equity	417,813		293,313		132,369	
bilities and ers Equity	**$ 3,249,190**		**$ 2,670,701**		**$ 1,623,214**	
st Income		**$ 136,996**		**$ 101,749**		**$ 56,621**
st Spread[3]		**3.89%**		**3.70%**		
st Margin[4]		**4.77%**		**4.26%**		

(1) *Loans are net of deferred fees and related direct costs. Loan fees have been included in the calculation of interest income. Loan fees were $5.6 million, $6.0 million and $3.2 million for the years ended December 31, 2005, 2004 and 2003, respectively.*

(2) *Yields on tax-exempt income have been computed on a tax-equivalent basis, using a tax rate of 35 percent.*

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

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

Table of Contents

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

	For the Year Ended December 31,					
	2005 vs. 2004 Increases (Decreases) Due to Change in			2004 vs. 2003 Increases (Decreases) Due to Change in		
	Volume	Rate	Total	Volume	Rate	Total
			(In thousands)			
Interest Income:						
Gross Loans, Net	$ 30,311	$ 31,889	$ 62,200	$ 49,212	$ 3,094	$ 52,306
Municipal Securities	161	(54)	107	1,576	18	1,594
Obligations of Other U.S. Government Agencies	477	151	628	725	254	979
Other Debt Securities	(929)	939	10	(335)	2,275	1,940
Equity Securities	401	(10)	391	429	14	443
Federal Funds Sold	930	476	1,406	(126)	32	(94)
Term Federal Funds Sold				(112)	(113)	(225)
Interest-Earning Deposits	(2)	1	(1)	6		6
Total Interest Income	31,349	33,392	64,741	51,375	5,574	56,949
Interest Expense:						
Money Market Checking	1,403	3,463	4,866	4,191	1,323	5,514
Savings	92	248	340	564	(668)	(104)
Time Deposits of $100,000 or More	8,385	12,633	21,018	4,060	(509)	3,551
	-	108,000				
Exchange differences on deposits and investments	10,880	(1)	41,917			
Stock based compensation	627,511	154,199	5,598,798			
Shares issued for services rendered	-	91,860	1,155,956			
Shares to be issued for services rendered	93,713	-	93,713			
Gain on sale of investment	(69,178)	-	(1,102,182)			
Impairment of investment	-	-	434,876			
Imputed interest	-	-	23,559			
Impairment of available for sale security	-	43,111	381,666			
Exchange of warrants	296,982	-	296,982			
Changes in fair value of warrant liabilities	(44,699)	-	98,005			

Changes in operating assets and liabilities:			
Accounts receivables and other current assets	(400,523)	(166,540)	(560,682)
Restricted cash	-	-	(16,000)
Accounts payable and accrued expenses	(198,401)	(85,435)	398,772
Liability of employee rights upon retirement	5,821	419	26,007
Provision for uncertain tax position	-	-	228,272
Total net cash used in operating activities	(3,115,165)	(1,959,262)	(14,000,545)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(4,659)	(2,129)	(130,271)
Acquisition of short-term investments and short term deposits	(1,862,817)	(500,000)	(7,766,552)
Funds in respect of employee rights upon retirement	(3,023)	(2,109)	(9,918)
Proceeds from sale of investment and marketable securities	226,671	450,000	676,671
Proceeds from sale of Short term deposits	-	1,800,000	5,428,000
Lease deposits, net	-	-	(7,509)
Total net cash derived from (used in) investing activities	(1,643,828)	1,745,762	(1,809,579)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from sales of common stock and warrants - net of issuance expenses	1,450,936	-	16,595,571
Receipts on account of shares issuances	-	-	6,061
Proceeds from convertible notes	-	-	275,000
Proceeds from short term note payable	-	-	120,000
Payments of short term note payable	-	-	(120,000)
Shareholder advances	-	-	66,243
Net cash derived from financing activities	1,450,936	-	16,942,875
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(17,786)	-	(27,854)
	(3,325,843)	(213,500)	1,104,897

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS			
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	4,430,740	1,513,365	-
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,104,897	$ 1,299,865	$ 1,104,897
Non cash investing and financing activities:			
Shares issued for offering costs	-	-	$ 77,779
Contribution to paid in capital	-	-	$ 18,991
Discount on convertible note related to beneficial conversion feature	-	-	$ 108,000
Exchange of warrants	$ 917,809	-	$ 917,809
Shares and warrants issued for marketable securities-	$ 628,630	-	$ 628,630

The accompanying notes are an integral part of the condensed consolidated financial statements.

F - 7

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

a. General:

Oramed Pharmaceuticals Inc. (the "Company") was incorporated on April 12, 2002, under the laws of the State of Nevada. From incorporation until March 3, 2006, the Company was an exploration stage company engaged in the acquisition and exploration of mineral properties. On February 17, 2006, the Company entered into an agreement with Hadasit Medical Services and Development Ltd. ("Hadasit") (the "First Agreement") to acquire the provisional patent related to orally ingestible insulin capsule to be used for the treatment of individuals with diabetes, see also note 2a.

On March 11, 2011, the Company was reincorporated from the State of Nevada to the State of Delaware.

In February 2013, the Company's common stock began trading on The Nasdaq Capital Market under the symbol ORMP.

On May 14, 2007, the Company incorporated a wholly-owned subsidiary in Israel, Oramed Ltd., which is engaged in research and development. Unless the context indicates otherwise, the term "Group" refers to Oramed Pharmaceuticals Inc. and its Israeli subsidiary, Oramed Ltd. (the "Subsidiary"), (together with the Company, "the Group").

The Group is engaged in research and development in the biotechnology field and is considered a development stage company in accordance with the ASC Topic 915 "Development Stage Entities" due to the fact that it has not generated any revenues from its operations.

Successful completion of the Company's development programs and its transition to normal operations is dependent upon obtaining necessary regulatory approvals from the FDA prior to selling its products within the United States, and foreign regulatory approvals must be obtained to sell its products internationally. There can be no assurance that the Company will receive regulatory approval of any of its product candidates, and a substantial amount of time may pass before the Company achieves a level of revenues adequate to support its operations, if at all. The Company also expects to incur substantial expenditures in connection with the regulatory approval process for each of its product candidates during their respective developmental periods. Obtaining marketing approval will be directly dependent on the Company's ability to implement the necessary regulatory steps required to obtain marketing approval in the United States and in other countries. The Company cannot predict the outcome of these activities.

Based on its current cash resources and commitments, and cash received in private offerings in the year ended August 31, 2012 and the nine month period ended May 31, 2013 (see note 4b), the Company believes it will be able to maintain its current planned development activities and the corresponding level of expenditures for at least the next 12 months, although no assurance can be given that it will not need additional funds prior to such time. If there are unexpected increases in general and administrative expenses or research and development expenses, the Company may need to seek additional financing during the next 12 months. See also note 6 with respect to the Company registered direct offering.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

b. Newly issued and recently adopted Accounting Pronouncements

1) In June 2011, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (ASU) 2011-05, an update to ASC No. 220, “Presentation of Comprehensive Income,” which eliminates the option to present other comprehensive income and its components in the statement of shareholders’ equity. The Company can elect to present the items of net income and other comprehensive income in a single continuous statement of comprehensive income or in two separate, but consecutive, statements. Under either method the statement would need to be presented with equal prominence as the other primary financial statements. The amended guidance, which must be applied retroactively, is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, with earlier adoption permitted. In December 2011, the FASB issued another update on the topic, which deferred the effective date pertaining only to the presentation of reclassification adjustments on the face of the financial statements. The Company adopted the pronouncement in the first quarter of fiscal year 2013.

2) In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 2013-02”). This update requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, ASU 2013-02 requires presentation, either on the face of the income statement or in the notes, of significant amounts reclassified out of accumulated other comprehensive income by respective line items of net income, but only if the amounts reclassified are required to be reclassified in their entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about these amounts. The amendments in ASU 2013-02 will be effective prospectively for annual reporting periods beginning after December 15, 2012, and interim periods within those annual periods. ASU 2013-02 is effective for the Company on August, 31, 2013. The Company does not expect the adoption of ASU 2013-02 to have a material effect on the consolidated financial statement presentation.

c. Condensed Consolidated Financial Statements Preparation

The condensed consolidated financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and on the same basis as the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended August 31, 2012 (the “2012 Form 10-K”). These condensed consolidated financial statements are not audited but in the opinion of management reflect all adjustments that are of a normal recurring nature and that are considered necessary for a fair statement of the results of the periods presented. Certain information and disclosures normally included in annual consolidated financial statements have been omitted in this interim period report pursuant to the rules and regulations of the SEC.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued):

Because the condensed consolidated interim financial statements do not include all of the information and disclosures required by U.S. GAAP for annual financial statements, they should be read in conjunction with the audited consolidated financial statements and notes included in the 2012 Form 10-K for the year ended August 31, 2012. The results for interim periods are not necessarily indicative of a full fiscal year's results.

d. Reclassifications

Certain figures in respect of prior years have been reclassified to conform to the current year presentation.

NOTE 2 - COMMITMENTS:

a. Under the terms of the First Agreement with Hadasit (note 1a above), the Company retained Hadasit to provide consulting and clinical trial services. As remuneration for the services provided under the agreement, Hadasit is entitled to $200,000. The primary researcher for Hadasit is Dr. Miriam Kidron, a director and officer of the Company. The funds paid to Hadasit under the agreement are deposited by Hadasit into a research fund managed by Dr. Kidron. Pursuant to the general policy of Hadasit with respect to its research funds, Dr. Kidron receives from Hadasit a management fee in the rate of 10% of all the funds deposited into this research fund. The total amount paid to Dr. Kidron out of this fund was $10,214.

On January 7, 2009, the Company entered into a second agreement with Hadasit (the "Second Agreement") which confirms that Hadasit has conveyed, transferred and assigned all of its ownership rights in the patents acquired under the First Agreement to the Company, and certain other patents filed by the Company after the First Agreement as a result of the collaboration between the Company and Hadasit.

On July 8, 2009, the Subsidiary entered into a third agreement with Hadasit, Prof. Itamar Raz and Dr. Miriam Kidron the "Third Agreement"), to retain consulting and clinical trial services from Hadasit. According to the Third Agreement, Hadasit was entitled to total consideration of $400,000 to be paid by Oramed. $200,000 of this amount was agreed in the terms of the First Agreement, and the remaining of $200,000 was paid in accordance with the actual progress of the study. The total amount was paid through May 31, 2011.

On September 11, 2011, the Subsidiary entered into a fourth agreement with Hadasit, Dr. Miriam Kidron and Dr. Daniel Schurr (the "Fourth Agreement"), to retain consulting and clinical trial services. According to the Fourth Agreement, Hadasit will be entitled to consideration of $200,000 to be paid by the Company in accordance with the actual progress of the study, $50,000 of which were paid and recognized through May 31, 2013.

b. On July 5, 2010, the Subsidiary of the Company entered into a Manufacturing Supply Agreement (MSA) with Sanofi-Aventis Deutschland GMBH ("sanofi-aventis"). According to the MSA, sanofi-aventis will supply the subsidiary with specified quantities of recombinant human insulin to be used for clinical trials in the United States.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 2 - COMMITMENTS (continued):

c. On February 15, 2011, the Subsidiary entered into a consulting agreement with a third party (the "Consultant") for a period of five years, pursuant to which the Consultant will provide consultation on scientific and clinical matters. The Consultant is entitled to a fixed monthly fee of $8,000, royalties of 8% of the net royalties actually received by the Subsidiary in respect of the patent that was sold to Entera Bio Ltd. ("Entera") on February 22, 2011 and an option to purchase up to 20,834 shares of common stock of the Company at an exercise price of $6.00 per share. The option vests in five annual installments commencing February 16, 2012 and expires on February 16, 2021. The initial fair value of the option on the date of grant was $62,185, using the Black Scholes option-pricing model and was based on the following assumptions: dividend yield of 0% for all years; expected volatility of 78.65%; risk-free interest rates of 3.62%; and the remaining expected term of 10 years. The fair value of the option as of May 31, 2013 was $129,683, using the following assumptions: dividend yield of 0% and expected term of 7.72 years; expected volatility of 76.16%; and risk-free interest rate of 1.75%. The fair value of the option granted is remeasured at each balance sheet reporting date and is recognized over the related service period using the straight-line method.

d. On February 15, 2012, the Company entered into an advisory agreement with a third party for a period of one year, pursuant to which such third party will provide investors relations services and will be entitled to a share based compensation as follows: 25,000 shares of common stock of the Company will be issued in six installments over the engagement period, commencing February 15, 2012, and a warrant to purchase 62,500 shares of common stock of the Company at an exercise price of $6.00 per share. The warrant vested in 12 monthly installments commencing February 15, 2012 and expires on February 15, 2017. The initial fair value of the option on the date of grant was $121,304, using the Black Scholes option-pricing model and was based on the following assumptions: dividend yield of 0% for all years; expected volatility of 76.82%; risk-free interest rates of 0.81%; and the remaining expected term of 5 years.

On July 3, 2012, the Company and the third party entered into an amendment to the agreement, according to which the original agreement will be extended until July 3, 2013 (unless terminated earlier by one of the parties), and a new payment schedule was determined for the remainder of the share based compensation until July 3, 2013. The Company records expenses in respect of this warrant during the term of the services.

The fair value of the option as of May 31, 2013, was $166,598, using the following assumptions: dividend yield of 0% and expected term of 4.0 years; expected volatility of 65.72%; and risk-free interest rate of 0.62%. The fair value of the option granted is remeasured at each balance sheet reporting date and is recognized over the related service period using the straight-line method.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 2 - COMMITMENTS (continued):

e. On March 18, 2012, the Subsidiary entered into a lease agreement for its office facilities in Israel. The lease agreement is for a period of 57 months commencing January 1, 2012. The monthly lease payment will be NIS 3,400 in 2012, NIS 4,225 in 2013 and NIS 5,610 from 2014 onwards, and will be linked to the increase in the Israeli consumer price index (as of May 31, 2013, the monthly payment in the Company's functional currency is $1,147, the future lease payments under the agreement will be $4,558 from July to September 2013). As security for its obligation under this lease agreement the Company provided a bank guarantee in an amount equal to three monthly lease payments.

On April 28, 2013, the Subsidiary entered into a new lease agreement for its office facilities in Israel. The new lease agreement is for a period of 36 months commencing October 1, 2013. The monthly lease payment will be NIS 5,589 in 2013 and NIS 7,421 from 2014 onwards, and will be linked to the increase in the Israeli consumer price index (as of May 31, 2013, the monthly payment in the Company's functional currency is $1,518, the future lease payments under the agreement will be $2,015 in 2014 onwards). As security for its obligation under this lease agreement the Company provided a bank guarantee in an amount equal to three monthly lease payments.

f. On September 27, 2012, the Subsidiary entered into a Master Services Agreement with Medpace, Inc. ("Medpace"), to retain it as a CRO, for its upcoming Phase 2 clinical trial for an oral insulin capsule, that was expected to start in the first calendar quarter of 2013 in the United States. As consideration for its services, the subsidiary will pay Medpace a total amount of approximately $3,500,000 that will be paid during the term of the engagement and based on achievement of certain milestones, $540,579 of which was paid through May 31, 2013. On March 17, 2013, due to a request from the FDA to perform a sub study before proceeding with the Phase 2 clinical trial, the Subsidiary instructed Medpace to temporarily cease all work. As a result, Medpace is required to return to the Subsidiary all funds in excess of the actual expenses paid for the clinical trial, at the amount of $219,867 and are presented as accounts receivable - other.

g. Grants from Bio-Jerusalem

The Subsidiary is committed to pay royalties to the Bio-Jerusalem fund on proceeds from future sales at a rate of 4% and up to 100% of the amount of the grant received by the Company (Israeli CPI linked) at the total amount of $65,053. As of May 31, 2013, the Subsidiary had not yet realized any revenues and did not incur any royalty liability.

In the nine months period ended May 31, 2013, the Company received $12,320 from the Bio-Jerusalem fund.

F - 12

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 2 - COMMITMENTS (continued):

h. Grants from the Office of the Chief Scientist ("OCS")

Under the terms of the Company’s funding from the Israeli Government, royalties of 3%-3.5% are payable on sales of products developed from a project so funded, up to 100% of the amount of the grant received by the Company (dollar linked) with the addition of annual interest at a rate based on LIBOR.

At the time the grants were received, successful development of the related projects was not assured. In case of failure of a project that was partly financed as above, the Company is not obligated to pay any such royalties.

On May 31, 2013, the Subsidiary had not yet realized any revenues from the said project and did not incur any royalty liability. The total amount that was actually received through May 31, 2013 was $1,332,374.

For the nine months period ended May 31, 2013, the research and development expenses are presented net of OCS and Bio-Jerusalem fund Grants, in the total amount of $101,639.

NOTE 3 - FAIR VALUE:

Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, the guidance establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

As of May 31, 2013, the assets measured at fair value are comprised of available for sale securities (level 1 and level 3).

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible.

Available-for-sale securities are reported at fair value with unrealized gains and losses, recorded as a separate component of other comprehensive income in equity until realized. Unrealized losses that are considered to be other-than-temporary are charged to statement of comprehensive loss as an impairment charge and are included in the consolidated statement of comprehensive loss under impairment of available-for-sale securities.

F - 13

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 3 - FAIR VALUE (continued):

The Company considers available evidence in evaluating potential impairments of its investments, including the duration and extent to which fair value is less than cost, and the Company's ability and intent to hold the investment. Realized gains and losses on sales of the securities are included in the consolidated statement of comprehensive loss as financial income or expenses.

Marketable securities consist wholly of equity securities of D.N.A Biomedical Solutions Ltd. ("D.N.A"), which were received in March 2011 as part of the consideration for selling the Company's equity method investee Entera, and in October 2012, as an option to purchase ordinary shares of D.N.A with no additional costs in exchange for the Company's common stock (the "D.N.A Option"). The D.N.A Option was exercised by the Company in February 2013. Those securities are classified as available-for-sale and are recorded at fair value.

The shares received on March 2011 are traded on the Tel Aviv Stock Exchange ("TASE") and have a quoted price. The fair value of those securities is measured at the quoted prices of the securities in an active market on the measurement date.

The D.N.A shares that were received upon realizing the D.N.A Option are restricted for a period of 6 months from realization date according to TASE policy with regards to private placements. The fair value of the D.N.A Option is measured based on the quoted prices of the otherwise identical unrestricted securities, adjusted for the effect of the restriction by applying a proper discount. The discount was determined with reference to other similar restricted instruments, and will be decreased over the restriction period. Similar securities, with no restriction on tradability, are quoted on an active market.

Transfers in and/or out of Level 3 are recognized in the beginning of the reporting period.

Financial assets carried at fair value as of May 31, 2013 and August 31, 2012 are classified in the tables below in one of the three categories described above:

	Level 1	Level 3	Total
Marketable securities:			
May 31, 2013	$ 113,920	$ 689,452	$ 803,372
August 31, 2012	$ 200,311	-	$ 200,311

The following table summarizes the activity for those financial assets where fair value measurements are estimated utilizing Level 3 inputs:

	Nine months ended May 31, 2013
Carrying value at the beginning of the period	$ -
Additions	628,630
Changes in fair value	113,165
Reclassification adjustment for gains included in net loss	(52,343)

Carrying value at the end of the period	$	689,452

As to financial liabilities carried at fair value, see note 5.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 4 - STOCK HOLDERS' EQUITY:

a. In September 2012, the Company issued 5,652 shares of its common stock and 2,826 common stock purchase warrant to an investor, with whom the Company entered into Securities Purchase Agreement in August 2012 for the same investment terms as described in note 4b. below.

b. Between September and November 2012, the Company entered into Securities Purchase Agreements with a number of investors for the sale of 329,832 units at a purchase price of $4.44 per unit for total consideration of $1,464,425. Each unit consisted of one share of the Company's common stock and one common stock purchase warrant. Each warrant entitles the holder to purchase 0.50 a share of common stock exercisable for five years at an exercise price of $6.00 per share. The investors were granted customary registration rights with respect to resales of shares, including the shares underlying the warrants. In addition, one of the investors who was previously considered as a leading investor (the "Leading Investor") , who purchased 405,405 of the units, was granted the right to maintain its percentage of the shares of the Company's common stock outstanding by purchasing more shares whenever the Company proposes to issue certain additional shares to other investors. Such right only exists so long as such investor holds at least 5% of the Company's outstanding common stock. In addition, such investor's warrants contained anti-dilution protection (the "full ratchet anti-dilution protection") and cashless exercise provisions not contained in the other investors' warrants. The other terms of the Leading Investor's Securities Purchase Agreement were substantially the same as those granted to him in 2011 for his first investment. See also note 5.

As a finder's fee, in connection with the securities purchase agreements, the Company paid cash consideration of $12,885, as well as issued 1,127 shares of the Company's common stock and 564 common stock purchase warrant for another individual. The Company also issued 12,745 shares of the Company's common stock and 6,373 common stock purchase warrant to a director as a finder's fee with respect to the Securities Purchase Agreements described above and to Securities Purchase Agreements to which the Company had entered into in August 2012.

c. On October 30, 2012, the Company entered into a Securities Purchase Agreement with D.N.A, according to which, the Company issued on that day to D.N.A 199,172 shares of its common stock, in consideration for the option to purchase up to 21,637,611 ordinary shares of D.N.A, valued at approximately $628,630 at the day of the transaction. The Company exercised the option in February 2013. As described in note 3, the Subsidiary had previously acquired 8,404,667 ordinary shares of D.N.A issued in March 2011. On February 14, 2013 the Subsidiary sold 3,500,000 of the D.N.A shares in a private transaction for a total of NIS 420,000 (or approximately $114,130). On March 5, 2013 the Subsidiary sold additional 3,500,000 of the D.N.A shares in a private transaction for a total of NIS 420,000 (or approximately $112,540). As of May 31, 2013 the Group own approximately 11.1% of D.N.A's outstanding ordinary shares.

d. On January 10, 2013, the Company's board of directors approved a reverse stock split at a ratio of one-for-twelve, effective January 22, 2013, which decreased the number of common shares issued and outstanding as of January 23, 2013, from approximately 86.5 million shares to approximately 7.2 million shares and the number of authorized common shares from 200 million shares to approximately 16.7 million shares. All share and per share amounts included in the condensed consolidated financial statements have been adjusted retroactively to reflect the effects of the reverse stock split.

F - 15

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 5 - WARRANTS

As part of the Company's private placements, warrants were granted to the Leading Investor, as defined in note 4b. 182,292 warrants were granted in January 2011 (the "2011 Warrants"), 112,613 were granted in August 2012 and 16,892 were granted in November 2012 (together, the "Three Warrants"). Each warrant was granted for five years at an initial exercise price of $6.00 per share. The warrants included a full ratchet anti-dilution protection from the second year anniversary date after issuing the warrant, subject to certain limitations and while the warrant was outstanding. In the event the Company was to issue or sell any common stock for a consideration per share lower than the exercise price then in effect, or was to issue or sell any options, warrants or other rights for the purchase or acquisition of such shares at a consideration per share of less than the exercise price then in effect, the warrants were to be amended to (a) reduce the exercise price to an amount equal to the per share consideration payable to the company in such sale or issuance, and (b) the quantity of warrants were to updated, based on certain rules as determined in the Warrants Agreements with the Leading Investor.

As a result of a private placements in August 2012, and pursuant to adjustment terms of the 2011 Warrants, such warrant was amended to: (i) reduce the exercise price from $6.00 to $4.44, (ii) increase the number of shares issuable upon the exercise of the warrant from 182,292 to 246,341.

In addition, as a result of the agreement with D.N.A, as described in note 4c, and pursuant to adjustment terms of the 2011 Warrants, the Company further amended the 2011 Warrants by: (i) reducing the exercise price from $4.44 to $3.7656 and (ii) increasing the number of shares issuable upon the exercise of the 2011 Warrants from 246,341 to 290,459.

On November 29, 2012, the Company and the Leading Investor entered into a letter agreement (the "Agreement") in connection with the Three Warrants. Pursuant to the Agreement, the Company and the Leading Investor agreed to amend the Three Warrants to provide that the anti-dilution protection of each of the Three Warrants shall be removed in its entirety. In addition, as to the Warrants issued in August and November 2012, the parties agreed that the exercise price shall be reduced to $3.7656. On that day, the Company also issued to the Leading Investor a Common Stock Purchase Warrant (the "New Warrant") pursuant to which, the Leading Investor shall have the right to purchase up to 137,311 shares of the common stock of the Company over a period of four years at an exercise price of $7.20 per share. The fair value of the New Warrant on the date of grant, was $145,173, using the following assumptions: dividend yield of 0% and expected term of 4 years; expected volatility of 62.29%; and risk-free interest rate of 0.57%.

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 5 - WARRANTS (continued):

The fair value of the warrants was determined by using Monte Carlo type model based on the risk neutral approach. The model takes as an input the estimated future dates when new capital will be raised, and builds a multi-step dynamic model. The first step is to model the risk neutral distribution of the share value on the new issue dates, then for each path to use the Black-Scholes model to estimate the value of the warrants on the last issue date including all the changes in exercise price and quantity along this path. The significant unobservable input used in the fair value measurement is the future expected issue dates. Significant delay in this input would result a higher fair value measurement.

In addition to the New Warrant, Nadav Kidron, the Company's President, Chief Executive Officer and director, in his personal capacity as a shareholder of the Company, undertook and agreed that following the execution and delivery of the Agreement, in the event that an adjustment pursuant to the anti-dilution protection of any of the Three Warrants (had it not been amended by the Agreement thereof) would have been triggered and the number of shares of common stock of the Company that the Leading Investor would have been able to purchase under the Three Warrants would have increased by an aggregate number in excess of 137,311 shares, then the Leading Investor shall have the right to purchase from Mr. Kidron such number of shares of common stock of the Company owned by Mr. Kidron equal to such excess, up to a maximum of 112,690 shares of common stock of the Company (the "Kidron Option"). The foregoing right shall survive until the termination of such Three Warrants. The fair value of the Kidron Option on the date of grant was $168,220, based on the Monte Carlo type model that is described above, and was recognized as part of the stockholders equity.

Pursuant to the removal of the anti-dilution protection, the Three Warrants were no longer classified as liabilities. The Company recognized a financial expense in the amount of $296,982 during the three months ended November 30, 2012.

Financial liabilities carried at fair value as of August 31, 2012, are classified in the tables below in one of the three fair value categories:

	Fair value measurements at reporting date using	
	Level 3	Total
Warrants -		
August 31, 2012	$ 637,182	$ 637,182

The following table summarizes the activity for those financial liabilities where fair value measurements are estimated utilizing Level 3 inputs:

	Nine months ended May 31, 2013
Carrying value at the beginning of the period	$ 637,182
Additional warrant liabilities granted	28,344

Changes in fair value of warrant liabilities		(44,699)
Exchange of warrants		(620,827)
Carrying value at the end of the period	$	-

ORAMED PHARMACEUTICALS Inc.
(A development stage company)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 6 - SUBSEQUENT EVENTS

On July 10, 2013, the Company entered into a Placement Agency Agreement with Aegis Capital Corp. as representative of the several placement agents (the "Placement Agents"), pursuant to which the Placement Agents agreed to use their reasonable best efforts to arrange for the sale of up to 658,144 shares of the Company’s common stock. In connection therewith, on July 10, 2013, the Company also entered into a Securities Purchase Agreement, pursuant to which the Company agreed to sell an aggregate of 658,144 shares of common stock, at a price of $7.00 per share, to various investors in a registered direct offering (the "Offering"). The Company had received all funds and issued all shares of common stock in connection with the Offering as of July 17, 2013. The net proceeds to the Company from the offering are approximately $4,200,000, after deducting Placement Agents' commissions and offering expenses of the Company.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the related notes included elsewhere herein and in our consolidated financial statements, accompanying notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report (as defined below).

Forward-Looking Statements

This Quarterly Report on Form 10-Q (including the section regarding Management's Discussion and Analysis of Financial Condition and Results of Operations) contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and other federal securities laws, regarding our business, clinical trials, financial condition, expenditures, results of operations and prospects. Words such as "expects," "anticipates," "intends," "plans," "planned expenditures," "believes," "seeks," "estimates" and similar expressions or variations of such words are intended to identify forward-looking statements, but are not deemed to represent an all-inclusive means of identifying forward-looking statements as denoted in this Quarterly Report on Form 10-Q. Additionally, statements concerning future matters are forward-looking statements.

Although forward-looking statements in this Quarterly Report on Form 10-Q reflect the good faith judgment of our management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties and actual results and outcomes may differ materially from the results and outcomes discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those specifically addressed under the heading "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended August 31, 2012, or our Annual Report, as filed with the Securities and Exchange Commission, or the SEC, on December 12, 2012, as amended on December 21, 2012, as well as those discussed elsewhere in our Annual Report and in this Quarterly Report on Form 10-Q. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Except as required by law, we undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Quarterly Report on Form 10-Q. Readers are urged to carefully review and consider the various disclosures made throughout the entirety of this Quarterly Report on Form 10-Q which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

Overview of Operations

We are a pharmaceutical company currently engaged in the research and development of innovative pharmaceutical solutions, including an orally ingestible insulin capsule to be used for the treatment of individuals with diabetes, and the use of orally ingestible capsules or pills for delivery of other polypeptides.

Recent business developments and financing activities

In September 2012, we entered into a Master Services Agreement with Medpace, Inc., or Medpace, to retain Medpace as a contract research organization, or CRO, for our upcoming Phase 2 clinical trial for an oral insulin capsule that was expected to start in the first calendar quarter of 2013 in the United States. As consideration for its services, we will pay Medpace a total amount of approximately $3,500,000 during the term of the engagement, based on the achievement of certain milestones. In March 2013, due to a request from the U.S. Food and Drug Administration, or FDA, for us to perform a sub study before proceeding with the Phase 2 clinical trial, we instructed Medpace to temporarily cease all work under the Master Services Agreement. We intend to resume the clinical trial at such time as we receive approval from the FDA.

In October 2012, we entered into a Securities Purchase Agreement with D.N.A Biomedical Solutions Ltd., or D.N.A, an Israeli company listed on the Tel Aviv Stock Exchange, according to which we issued to D.N.A 199,172 shares of our common stock in consideration for an option to purchase up to 21,637,611 ordinary shares of D.N.A, or the D.N.A Option. We had previously acquired 8,404,667 ordinary shares of D.N.A issued in March 2011. In February 2013, we exercised the D.N.A Option. In addition, in February and March 2013 we sold a total amount of 7,000,000 of our D.N.A ordinary shares, of which 5,250,000 ordinary shares were issued to us in March 2011 and 1,750,000 ordinary shares were issued to us in February 2013 upon our exercise of the D.N.A Option. The ordinary shares were sold in private transactions for a total of NIS 840,000 (or approximately $226,670, based on the exchange rate between the NIS and the U.S. dollar, as quoted by the Bank of Israel on the dates of sale), before brokerage fees. The selling price per share in both transactions was below market price. As of July 16, 2013, we own approximately 11.1% of D.N.A's outstanding ordinary shares.

Between September and November 2012, we completed private placements pursuant to which we sold to certain investors an aggregate of 335,477 "units" at a purchase price of $4.44 per unit for total consideration of $1,489,518. Each unit consisted of one share of common stock and a five-year warrant to purchase 0.50 of a share of common stock at an exercise price of $6.00 per share. In connection with such private placements, we paid cash compensation of $12,885 as a finder's fee. We also issued 1,127 shares of common stock and warrants to purchase 564 shares of common stock as a finder's fee to a third-party in connection with the private placements and issued 12,745 shares of common stock and warrants to purchase 6,373 shares of common stock as a finder's fee to one of our directors, Leonard Sank.

In November 2012, we entered into a letter agreement, or the Agreement, with Regals Fund LP, or Regals, in connection with (1) the warrant originally issued in January 2011, as amended in August 2012 and November 2012, to purchase up to 290,459 shares of our common stock, (2) the warrant dated August 28, 2012, to purchase up to 112,613 shares of our common stock and (3) the warrant dated November 5, 2012, to purchase up to 16,892 shares of our common stock , or together, the Warrants. Pursuant to the Agreement, we and Regals agreed to amend the Warrants to provide that the anti-dilution protection of the Warrants shall be deleted in its entirety. In addition, as to the warrants issued in August and November 2012, the parties agreed to reduce the exercise price to $3.7656 per share, the current exercise price per share of the warrants originally issued in January 2011. At such time, we also issued to Regals a warrant, or the New Warrant, pursuant to which Regals shall have the right to purchase up to 137,311 shares of our common stock over a period of four years at an exercise price of $7.20 per share.

3

In connection with the New Warrant, Nadav Kidron, our President, Chief Executive Officer and a director, in his personal capacity as one of our shareholders, agreed that following the execution and delivery of the Agreement, in the event that an adjustment pursuant to the anti-dilution protection of the Warrants (had they not been amended by the Agreement) would have been triggered and the number of shares of our common stock that Regals would have been able to purchase under the Warrants would have increased by an aggregate number in excess of 137,311 common shares, then Regals shall have the right to purchase from Mr. Kidron such number of shares of our common stock owned by Mr. Kidron, up to a maximum of 112,690 shares of our common stock. This right shall survive until the termination of the Warrants.

In December 2012 and March 2013, we were issued patents by the South African and Japanese Patent Offices, respectively, which cover part of our technology with respect to the oral delivery of peptides.

In December 2012, we filed an Investigational New Drug, or IND, application with the FDA to begin a Phase 2 clinical trial of our orally ingested insulin capsule, in order to evaluate the safety, tolerability and efficacy of our oral insulin capsule on type 2 diabetic volunteers. We have been communicating with the FDA regarding such Phase 2b IND application, and, according to the FDA's request, are conducting a Phase 2a sub study before we may proceed with the Phase 2b clinical trial. We expect to begin the Phase 2b clinical trial in the second quarter of 2014.

In January 2013, we began a clinical trial for our oral exenatide capsule on healthy volunteers and type 2 diabetic patients. We expect to receive results from such trial in the third quarter of calendar year 2013.

In January 2013, we effected a reverse stock split of our shares of common stock at a ratio of one-for-twelve.

In February 2013, we commenced a first human clinical trial on healthy volunteers with our oral insulin capsule delivered in combination with our oral exenatide capsule.

In February 2013, our common stock began trading on The Nasdaq Capital Market under the symbol ORMP.

In April 2013, we filed a new IND application with the FDA for the above discussed sub study on our oral insulin capsule.

In May 2013, the FDA cleared the Phase 2a sub study IND application, which is an in-patient study with 30 individuals that began in July 2013, and is expected to be completed in the third quarter of 2013.

In July 2013, we entered into a Placement Agency Agreement with Aegis Capital Corp. as representative of the several placement agents, or the Placement Agents, pursuant to which the Placement Agents agreed to use their reasonable best efforts to arrange for the sale of up to 658,144 shares of our common stock. In connection therewith, on July 10, 2013, we also entered into a Securities Purchase Agreement, pursuant to which we agreed to sell an aggregate of 658,144 shares of common stock, at a price of $7.00 per share, to various investors in a registered direct offering, or the Offering. We had received all funds and issued all shares of common stock in connection with the Offering as of July 17, 2013. Our aggregate net proceeds from the offering are approximately $4,200,000, after deducting Placement Agents' commissions and offering expenses.

Results of Operations

Comparison of nine and three month periods ended May 31, 2013 and May 31, 2012

The following table summarizes certain statements of operations data for the Company for the nine and three month periods ended May 31, 2013 and May 31, 2012:

	Nine months ended		Three months ended	
	May 31, 2013	May 31, 2012	May 31, 2013	May 31, 2012
Research and development expenses	$ 1,977,258	$ 1,144,415	$ 835,636	$ 249,752
General and administrative expenses	1,349,081	802,273	499,034	290,668
Impairment of available for sale securities	-	43,111	-	-
Financial (income) expense, net	114,629	24,460	(78,329)	9,945
Net loss for the period	$ 3,440,968	$ 2,014,259	$ 1,256,341	$ 550,365

Research and development expenses

Research and development expenses include costs directly attributable to the conduct of research and development programs, including the cost of salaries, payroll taxes, employee benefits, costs of registered patents materials, supplies, the cost of services provided by outside contractors, including services related to our clinical trials, clinical trial expenses, the full cost of manufacturing drug for use in research, preclinical development. All costs associated with research and development are expensed as incurred.

Clinical trial costs are a significant component of research and development expenses and include costs associated with third-party contractors. We outsource a substantial portion of our clinical trial activities, utilizing external entities such as CROs, independent clinical investigators, and other third-party service providers to assist us with the execution of our clinical studies.

Clinical activities which relate principally to clinical sites and other administrative functions to manage our clinical trials are performed primarily by CROs. CROs typically perform most of the start-up activities for our trials, including document preparation, site identification, screening and preparation, pre-study visits, training, and program management.

5

Clinical trial and pre-clinical trial expenses include regulatory and scientific consultants' compensation and fees, research expenses, purchase of materials, cost of manufacturing of the oral insulin capsules, payments for patient recruitment and treatment, costs related to the maintenance of our registered patents, costs related to the filings of patent applications, as well as salaries and related expenses of research and development staff.

During the nine months ended May 31, 2013, research and development expenses totaled $1,977,258, compared to $1,144,415 for the nine months ended May 31, 2012. The increase is mainly attributable to the preparation for the FDA approved Phase 2a and Phase 2b clinical trials as well as to the increase in stock based compensation costs, which during the nine months ended May 31, 2013 totaled $301,804, as compared to $53,111 during the nine months ended May 31, 2012.

During the three months ended May 31, 2013, research and development expenses totaled $835,636, compared to $249,752 for the three months ended May 31, 2012. The increase in research and development expenses during the three months ended May 31, 2013, as compared to the three months ended May 31, 2012, is attributable to the same reasons discussed above.

Government grants

In May 2012, Oramed Ltd. was granted a third grant amounting to a total net amount of NIS 595,000 (approximately $148,000) from the Office of the Chief Scientist of the Ministry of Industry, Trade and Labor of Israel, or OCS, which was designated for research and development expenses for the period of September 2012 to December 2012. In May 2013, Oramed Ltd. was granted a fourth grant amounting to a total net amount of NIS 975,000 (approximately $265,000) from the OCS, which was designated for research and development expenses for the period of January 2013 to December 2013. We used, and are using with respect to the May 2013 grant, the funds to support further research and development and clinical studies of our oral insulin capsule and oral GLP-1 analog.

In the nine and three months ended May 31, 2013, we recognized research and development grants in an amount of $89,319 and $79,261, respectively, and in the nine and three months ended May 31, 2012, we recognized research and development grants in an amount of $263,463 and $206,425, respectively. As of May 31, 2013, we had no contingent liabilities to the OCS.

Grants from the Bio-Jerusalem fund

We are committed to pay royalties to the Bio-Jerusalem fund on proceeds from future sales at a rate of 4% and up to 100% of the amount of the grant received by the Company (Israeli CPI linked) in the total amount of $65,053. As of May 31, 2013, we had not yet realized any revenues since inception and thus did not incur any royalty liability to the Bio-Jerusalem fund.

For the nine month periods ended May 31, 2013 and May 31, 2012, we received $12,320 and $0, respectively, from the Bio-Jerusalem fund.

General and administrative expenses

General and administrative expenses include the salaries and related expenses of our management, consulting costs, legal and professional fees, traveling, business development costs, insurance expenses and other general costs.

For the nine months ended May 31, 2013, general and administrative expenses totaled $1,349,081 compared to $802,273 for the nine months ended May 31, 2012. The increase in costs incurred related to general and administrative activities during the nine months ended May 31, 2013, reflects an increase in stock based compensation costs, arising from options granted to employees and consultants, of $224,619, as well as an increase in legal fees and consulting expenses. During the nine months ended May 31, 2013, as part of our general and administrative expenses, we incurred $325,707 related to stock options granted to employees and consultants, as compared to $101,088 during the nine months ended May 31, 2012.

For the three months ended May 31, 2013, general and administrative expenses totaled $499,034 compared to $290,668 for the three months ended May 31, 2012. The increase in general and administrative expenses during the three months ended May 31, 2013, as compared to the three months ended May 31, 2012, is mainly attributable to an increase in legal fees and accounting expenses.

Financial income/expense, net

Financial expenses for the nine months ended May 31, 2013 includes an expense of $114,629 resulting mainly from the removal of the anti-dilution protections from warrant liabilities and the grant of new warrants.

In the nine months ended May 31, 2013, we incurred income from exchange rate differences resulting from the decrease in the exchange rate between the NIS and the dollar during the period and its effect on our NIS linked bank deposits, as well as interest income on available cash and cash equivalents that were partially offset by bank charges. In the nine months ended May 31, 2013, we received a higher amount of interest income on available cash and cash equivalents, as compared to the nine months ended May 31, 2012, which was offset by bank charges.

During the three months ended May 31, 2013, financial income totaled $78,329, compared to financial expenses of $9,945 for the three months ended May 31, 2012. Financial income during the three months ended May 31, 2013, as compared to the three months ended May 31, 2012, is attributable to the same reasons discussed above.

Other comprehensive income

Subsequent increase in the fair value of available for sale securities previously written down as impaired for the nine months ended May 31, 2013 of $84,010 resulted from the increase in fair value of our D.N.A ordinary shares, at the amount of the impairment that was recognized in previous periods. Reclassification adjustment for gains included in net loss for the nine months ended May 31, 2013 of $69,178, resulted from the sale of 7,000,000 of our D.N.A ordinary shares in February and March 2013. Unrealized gain on available for sale securities for the nine months ended May 31, 2013 of $117,092, resulted from the increase in fair value of our D.N.A ordinary shares.

Reclassification adjustment for gains included in net loss and unrealized gain on available for sale securities for the three months ended May 31, 2013, resulted from the same reasons discussed above.

Impairment of available for sale securities for the nine months ended May 31, 2012 of $43,111 resulted from the decrease in fair value of our D.N.A ordinary shares.

Liquidity and capital resources

From inception through May 31, 2013, we incurred losses in an aggregate amount of $21,332,745. We have financed our operations through the private placements of equity financing, raising a total of $16,595,571, net of transaction costs. We will seek to obtain additional financing through similar sources, or public offerings, in the future as needed. As of May 31, 2013, we had $1,104,897 of available cash, $2,323,947 of short term bank deposits and $803,372 of marketable securities. Marketable securities are presented at fair value and their realization is subject to certain limitations if sold through the market, and are exposed to market risk. There is no assurance that at the time of sale of the marketable securities the price per share will be the same or higher, nor that we will be able to sell all of the securities at once given the volume of securities we hold. We anticipate that we will require approximately $5.2 million to finance our activities during the 12 months following May 31, 2013.

In July 2013, we entered into a Placement Agency Agreement with Aegis Capital Corp. as representative of the several placement agents, or the Placement Agents, pursuant to which the Placement Agents agreed to use their reasonable best efforts to arrange for the sale of up to 658,144 shares of our common stock. In connection therewith, on July 10, 2013, we also entered into a Securities Purchase Agreement, pursuant to which we agreed to sell an aggregate of 658,144 shares of common stock, at a price of $7.00 per share, to various investors in a registered direct offering, or the Offering. We had received all funds and issued all shares of common stock in connection with the Offering as of July 17, 2013. Our aggregate net proceeds from the offering are approximately $4,200,000, after deducting Placement Agents' commissions and offering expenses.

Management is in the process of evaluating various additional financing alternatives, as we will need to finance future research and development activities and general and administrative expenses through fund raising in the public or private equity markets. Although there is no assurance that we will be successful with those initiatives, management believes that it will be able to secure the necessary financing as a result of ongoing financing discussions with third party investors and existing stockholders as well as through additional funding from the OCS.

During the nine month period ended May 31, 2013, cash and cash equivalents decreased to $1,104,897 from the $4,430,740 reported as of August 31, 2012, which is due to the reasons described below.

Operating activities used cash of $3,115,165 in the nine months ended May 31, 2013, as compared to $1,959,262 used in the nine months ended May 31, 2012. Cash used for operating activities in the nine months ended May 31, 2013 primarily consisted of net loss resulting from research and development and general and administrative expenses, partially offset by stock based compensation adjustments and exchange of warrants, while cash used by operating activities in the nine months ended May 31, 2012 primarily consisted of net loss resulting from research and development and general and administrative expenses.

During the nine month period ended May 31, 2013, of the $89,319 in OCS grants we recognized during such period, we received none towards our research and development expenses, while in the nine months ended May 31, 2012, we received $158,672 towards our research and development expenses. The amounts that were recognized but not received during the nine months ended May 31, 2013 are expected to be received from the OCS following the submission of periodic and final reports by Oramed Ltd., and their examination by the OCS. The OCS has supported our activity in the past three years.

Investing activities used cash of $1,643,828 in the nine months ended May 31, 2013, as compared to $1,745,762 that was provided in the nine months ended May 31, 2012. Cash used in investing activities in the nine months ended May 31, 2013 consisted primarily of acquisition of short-term bank deposits. Cash provided by investing activities in the nine months ended May 31, 2012 consisted primarily of proceeds from the sale of our investment in Entera Bio Ltd.

Financing activities provided cash of $1,450,936 in the nine months ended May 31, 2013, as compared to $0 for the nine months ended May 31, 2012. Cash provided by financing activities during the nine months ended May 31, 2013 consisted of proceeds from our issuance of common stock and warrants as further discussed above under "Overview of Operations—Recent business developments and financing activities".

Off-balance sheet arrangements

As of May 31, 2013, we had no off balance sheet arrangements that have had or that we expect would be reasonably likely to have a future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Planned Expenditures

The estimated expenses referenced herein are in accordance with our business plan. Since our technology is still in the development stage, it can be expected that there will be changes in some budgetary items. Our planned expenditures for the twelve months beginning June 1, 2013 are as follows:

Category	Amount
Research and development, net of OCS funds	$3,592,000
General and administrative expenses	1,628,000
Total	$5,220,000

As indicated above, in December 2012 and April 2013, we filed IND applications with the FDA for our orally ingested insulin and we are conducting, or planning to conduct, further clinical studies with our exenatide capsule and the combination therapy, respectively, and others. Our ability to complete these expected activities is dependent on several major factors including the ability to attract sufficient financing on terms acceptable to us and receiving additional grants from the OCS.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, we are not required to provide the information required by this Item.

ITEM 4 - CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of May 31, 2013. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended May 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 5 – OTHER INFORMATION

On July 17, 2013, the Compensation Committee of our Board of Directors approved base salaries, effective on July 1, 2013, for each of our named executive officers (as defined in Item 402(m)(2) of Regulation S-K promulgated by the Securities and Exchange Commission) in the amounts, set forth below.

Name and Principal Position	Base Salary
Nadav Kidron President and CEO and director	$ 250,000
Miriam Kidron Chief Medical and Technology Officer and director	$ 200,000
Yifat Zommer CFO, Treasurer and Secretary	$ 150,000

The Compensation Committee also approved the use of a company car by each of Mr. Kidron and Ms. Kidron, in addition to their respective base salaries, pursuant to the Consulting Agreement by and between Oramed Ltd., our wholly-owned Israeli subsidiary, and KNRY, Ltd., entered into as of July 1, 2008 for the services of Mr. Kidron, previously filed as an exhibit to our current report on Form 8-K filed on July 2, 2008, and the Consulting Agreement by and between Oramed Ltd. and KNRY, Ltd., entered into as of July 1, 2008 for the services of Ms. Kidron, previously filed as an exhibit to our current report on Form 8-K filed on July 2, 2008, in each case as amended to date.

As approved by the Compensation Committee, Ms. Zommer's base salary includes the use of a company car pursuant to the Employment Agreement dated as of April 19, 2009, by and between Oramed Ltd. and Ms. Zommer, previously filed as an exhibit to our current report on Form 8-K filed on April 22, 2009, as amended to date.

In addition, the Compensation Committee also approved a cash bonuses to Mr. Kidron and Ms. Kidron in the amount of $60,000 and $20,000, respectively.

The amounts payable to each of the named executive officers will be paid in Israeli new shekels at an exchange rate of NIS 3.6 to $1.

ITEM 6 - EXHIBITS

Number	Exhibit
10.1	Employment Agreement, dated April 14, 2013, between Oramed Ltd. and Joshua Hexter. (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed April 16, 2013, File No. 000-50298).
31.1 *	Certification Statement of Principal Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended.
31.2 *	Certification Statement of Principal Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as amended.
32.1 **	Certification Statement of Principal Executive Officer pursuant to 18 U.S.C. Section 1350.
32.2 **	Certification Statement of Principal Financial Officer pursuant to 18 U.S.C. Section 1350.
101.1 **	The following financial statements from the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2013, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Comprehensive Loss, (iii) Condensed Consolidated Statements of Changes in Stockholders' Equity, (iv) Condensed Consolidated Statements of Cash Flows and (v) the Notes to Condensed Consolidated Financial Statements, tagged as blocks of text and in detail.

---

* Filed herewith
** Furnished herewith

12

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	ORAMED PHARMACEUTICALS INC.	
Date: July 17, 2013	By:	/s/ Nadav Kidron Nadav Kidron President and Chief Executive Officer
Date: July 17, 2013	By:	/s/ Yifat Zommer Yifat Zommer Chief Financial Officer (principal financial and accounting officer)

13