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COMMUNITY WEST BANCSHARES /
Form 10-K/A
April 30, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
Amendment No. 1

ANNUAL REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the fiscal year ended December 31, 2001

or

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

For the transition period from _____ to _____

Commission File Number: 000-23575

COMMUNITY WEST BANCSHARES
(Exact name of registrant as specified in its charter)

California 77-0446957
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

445 Pine Avenue, Goleta, California 93117
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (805) 692-1862

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE EXCHANGE ACT:

None

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE EXCHANGE ACT:

Common Stock, No Par Value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained, and will not be contained, to the best of the 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.

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing price of the stock on the Nasdaq National Market System on April 12, 2002, was approximately \$20,967,260. There were 5,690,224 shares of Common Stock of the registrant issued and outstanding as of April 12, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

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Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2002 Annual Meeting are incorporated by reference into Part III of this Report. The proxy statement will be filed with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year ended December 31, 2001.

COMMUNITY WEST BANCSHARES FORM 10-K/A

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PART I

ITEM 1. DESCRIPTION OF BUSINESS

This 2001 Annual Report on Form 10-K contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities

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Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Those forward-looking statements include statements regarding the intent, belief or current expectations of the Company and its management. Any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and actual results may differ materially from those projected in the forward-looking statements. Such risks and uncertainties include, among other things, the reduction in our earnings by losses on loans, the recent decline in our interest income, the risk that our borrowers will fail to perform, the regulation of the banking industry, our compliance with our Formal Agreement with the OCC and our Memorandum of Understanding with the Reserve Bank, our dependence on real estate, risks associated with high loan-to-value real estate loans, risks of natural disasters, the effect of interest rate fluctuations, competition, operations risks, adverse publicity and legal proceedings, curtailment of government guaranteed loan programs, the Company's expectation not to pay dividends, volatility of the Company's stock price, security risks related to online banking services, dependence on key employees, environmental laws, and other risk and uncertainties that may be detailed herein. See "Item 1. Description of Business - Factors that May Affect Future Results of Operations."

GENERAL HISTORY

Community West Bancshares was incorporated in the State of California on November 26, 1996, for the purpose of forming a bank holding company. On December 31, 1997, Community West Bancshares acquired a 100% interest in Goleta National Bank, herein referred to as "Goleta." Effective that date, shareholders of Goleta (NASDAQ: GLTB) became shareholders of Community West Bancshares (NASDAQ: CWBC) in a one-for-one exchange. The acquisition was accounted at historical cost in a manner similar to a pooling-of-interests. Community West Bancshares and Goleta are referred to herein as the "Company." "Bancshares" refers to the parent company only.

On December 14, 1998, the Company acquired a 100% interest in Palomar Savings & Loan Association, now known as Palomar Community Bank, herein referred to as "Palomar." As of that date, shareholders of Palomar became shareholders of Community West Bancshares by receiving 2.11 shares of Bancshares for each share of Palomar they held. The acquisition was accounted for under the purchase method. On August 17, 2001, the Company's 100% interest in Palomar was sold to Centennial First Financial Services.

On October 16, 1997, the Company purchased a 70% interest in Electronic Paycheck, LLC, a California limited liability company that is a provider of customized debit card payment systems and electronic funds transfer services. On November 4, 1999, Electronic Paycheck, LLC merged with ePacific.com Incorporated, a Delaware corporation. The merger was accounted for in a manner similar to a pooling-of-interests. ePacific.com has developed an Internet-based transaction processing system using proprietary software. The system provides complete front-end to back-end electronic funds transfer processing services. ePacific.com markets its e-commerce payment services to consumer lenders, companies with employees without banking relationships, network marketing organizations and loyalty reward programs. On March 30, 2000, ePacific.com redeemed 1,800,000 of the 2,100,000 shares held by the Company and repaid a loan from the Company with a balance of \$3,725,000, all for \$4,500,000 in cash. The Company continues to hold 300,000 shares of ePacific.com's common stock, which it carries at \$0 on its balance sheet.

In March 2000, Goleta entered into an agreement (the "Formal Agreement") with its principal regulator, the Office of the Comptroller of the Currency (the "OCC"). The Formal Agreement requires Goleta to maintain certain capital levels and to adhere to certain operational and reporting requirements which could limit Goleta's business activity and increase expense. Management has been

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informed by the OCC that they do not believe that Goleta is in full compliance with certain provisions of the Formal Agreement, which failure could adversely affect the safety and soundness of Goleta and subject Goleta to additional corrective and enforcement action by the OCC. The OCC has also expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make short-term consumer loans and believe this program subjects Goleta and the Company to significant strategic, reputational,

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compliance and transaction risks. See "Item 1. Description of Business - Factors That May Affect Future Results of Operations - Formal Agreement," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation - Formal Agreement With the OCC," and Note 15 of Notes to Consolidated Financial Statements.

RECENT RESULTS

The Company reported a net loss of \$3,912,287, or \$0.69 per share (both undiluted and diluted), for the fourth quarter of 2001. The fourth quarter loss was the result of a number of factors including, but not limited to: a) a loan loss provision of \$3,251,181; b) a reduction in SBA loan originations and sales which reduced gain on sale of loans to \$6.6 million; c) an increase in the prepayment assumptions used to calculate the value of Goleta's SBA related interest-only strip and servicing assets (\$858,000); and d) a refinement of the Company's estimated income tax expense relating to general operations (\$600,000) and the sale of Palomar (\$246,296). The Company also made accounting adjustments for a number of items including: a) the carrying values of accrued interest income and expense (an expense of \$892,536); b) bond discount (an expense of \$691,982); and c) bond issuance expense (a gain of \$320,219).

LINES OF BUSINESS

The Company, through its subsidiary, Goleta, offers a range of commercial and retail financial services, including the acceptance of demand, savings, and time deposits, and the origination of commercial, U.S. Small Business Administration, herein referred to as "SBA," real estate, construction, home improvement, short-term consumer, and other installment and term loans. It also offers cash management, remittance processing, electronic banking, merchant credit card processing, online banking, and other financial services to the public.

RELATIONSHIP BANKING

Relationship banking is conducted at the community level through two full-service branches, one in Goleta, California, and the other in Ventura, California. The primary customers are individuals and small to mid-sized businesses in these communities. Products offered through the relationship bank include demand, savings, and time deposit accounts, as well as commercial, accounts receivable, real estate, construction, home improvement and installment and term loans. Customers are also provided an array of ancillary services, including remittance banking, merchant card processing, courier service, on-line banking, and debit and credit cards.

SBA LENDING

Goleta has been an approved lender/servicer of loans guaranteed by the SBA since late 1990. The Company originates SBA loans, sells the guaranteed portion into the secondary market, and services the loans. The Company may, from time to time, also sell some of the unguaranteed portions of the SBA loans which it

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originates. The Company operates full-service SBA origination offices in Goleta, California and Atlanta, Georgia. During 1995, the SBA designated the Company as a "Preferred Lender." As a "Preferred Lender," the Company has the ability to move loans through the approval process at the SBA much more quickly than financial institutions that do not have such a designation. The Company currently has SBA "Preferred Lender" status in the California districts of Los Angeles, Fresno, Sacramento, San Francisco, and Santa Ana. The Company also has "Preferred Lender" status in Georgia, South Carolina, Tennessee, Colorado, Washington, Nevada, Oregon, and Florida.

In 2001, the Company began offering Business & Industry ("B & I") loans and was ranked the 16th largest B & I lender in the country in 2001. These loans are similar to the SBA product, except they are guaranteed by the U.S. Department of Agriculture and are generally larger loans made to larger businesses. Similar to the SBA product, they can be sold on the secondary market.

MORTGAGE LENDING

In 1995, the Company established a Wholesale and Retail Mortgage Loan Center. The Mortgage Loan Center originates residential real estate loans and manufactured housing loans primarily in the California counties of Ventura and

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Santa Barbara. After origination, the real estate loans are sold into the secondary market and the manufactured housing loans are retained in Goleta's portfolio.

From 1994 to 1998, the Company originated home improvement loans under the Title I regulations of the Federal Housing Authority, herein referred to as "FHA." This is the oldest government insured loan program in existence, having begun in 1934. After origination, the Title I loans were sold into the secondary market, and the servicing was retained by the Company. During this period, the Company was one of a small number of institutions approved to sell Title I loans directly to the Federal National Mortgage Association, herein referred to as the "FNMA." The Company no longer originates Title 1 loans.

In 1996, the Company began offering second mortgage loans. Second mortgage loans allow borrowers to borrow, up to 125% of their home's appraised value, when combined with the balance of the first mortgage loan, or a maximum of \$100,000. Proceeds are commonly used for debt consolidation, home improvement, or school tuition. The Company relies primarily on the creditworthiness of the borrower, combined with the underlying home value as collateral, to help ensure repayment of these loans. The repayment term on these loans range from one to 25 years.

In March 1998, the Company began accumulating the majority of these second mortgage loans for the purpose of securitization. Securitization is a process in which the accumulated loans are transferred into a trust in exchange for cash and an interest in the trust. The loans held in the trust are used as collateral to issue bonds to third party investors to generate the cash. An insurance policy is carried on the trust to guarantee full payment of the bonds. On December 22, 1998, the Company completed the securitization of an \$81 million pool of loans. On June 18, 1999, the Company completed the securitization of a \$122 million pool of loans. In the fourth quarter of 1999, the Company decided to cease securitization activities. The Company now sells its residential real estate loans and second mortgage loans into the secondary market on a whole loan basis

SHORT-TERM CONSUMER LENDING

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In 1999, Goleta entered into a contract with America's Cash Express, herein referred to as "ACE," and ePacific.com whereby ACE acts as an agent to originate short-term consumer loans at over 1,100 national retail offices. Upon origination, ACE purchases 90% of the principal and Goleta currently retains 10% ownership in the principal of each loan. Loans currently yield approximately 338% interest and are for original terms of two weeks. The first loans of this type were initiated in the second quarter of 2000. ACE and ePacific.com service these loans. While this business activity makes significant contributions to Goleta's net profit, it does experience high levels of loan losses. The OCC has also expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make short-term consumer loans and believe this program subjects Goleta and the Company to significant strategic, reputational, compliance and transaction risks. See "- Factors That May Affect Future Results of Operations."

FACTORS THAT MAY AFFECT FUTURE RESULTS OF OPERATIONS

The short and long-term success of the Company is subject to certain risks, many of which are substantial in nature. Shareholders and prospective shareholders in the Company should consider carefully the following risk factors, in addition to other information contained herein. This Annual Report on Form 10-K contains forward-looking statements which are subject to a variety of risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below.

NET INTEREST INCOME HAS RECENTLY DECLINED SIGNIFICANTLY

Net interest income declined by approximately \$4.9 million, or 23.5%, to \$20.8 million in 2001. Approximately \$4.6 million of this decrease was due to a decrease in the balance of Goleta's securitized loan portfolios. This decrease occurred, in part, because of an accelerated rate of prepayment of these loans. Continued high prepayment rates on these loans will reduce future net interest income.

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EARNINGS HAVE RECENTLY BEEN REDUCED BY LOSSES ON LOANS

The Company's income after provision for loan losses for 2001 was \$21,762, and if not for income tax benefits the Company would have experienced a loss of approximately \$1.26 million. The Company's provision for loan losses was approximately \$6.8 million in 2000 and \$11.9 million in 2001. If the performance of the Company's loan portfolio does not improve in 2002, the Company may again experience severely reduced earnings or losses.

BORROWERS COULD FAIL TO PERFORM

If a significant number of Goleta's borrowers and guarantors fail to perform their obligations as required by the terms of their loans, larger than expected loan losses could result. This risk increases when the economy is weak. In 2001, Goleta recorded a provision for loan losses of approximately \$11.9 million, principally as the result of deterioration in Goleta's SBA, second mortgage and securitized loan portfolios, and as the result of the growth in Goleta's short-term consumer lending portfolio. The Company has established an evaluation process designed to determine the adequacy of the allowance for loan losses. While this evaluation process uses historical and other objective information, the classification of loans and the establishment of loan losses are dependent to a great extent on experience and judgment. The Company cannot assure you that its allowance for loan losses will be sufficient to absorb

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future loan losses or prevent a material adverse effect on its business, profitability or financial condition. Earnings will continue to be at risk as long as weak economic conditions persist.

REGULATION

The financial services industry is heavily regulated. The Company is subject to federal and state regulation designed to protect the deposits of consumers, not to benefit shareholders. These regulations include the following:

- the amount of capital the Company must maintain;
- the kinds of activities it can engage in;
- the kinds and amounts of investments it can make;
- the locations of its offices;
- how much interest Goleta can pay on demand deposits;
- insurance of the Company's deposits and the premiums paid for this insurance; and
- how much cash the Company must set aside as reserves for deposits.

The regulations impose significant limitations on operations, and may be changed at any time, possibly causing future results to vary significantly from past results. Government policy and regulation, particularly as implemented through the Federal Reserve System, significantly affects credit conditions. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation."

FORMAL AGREEMENT

In March 2000, Goleta entered into the Formal Agreement with its principal regulator, the Office of the Comptroller of the Currency (the "OCC"). The Formal Agreement requires Goleta to maintain certain capital levels and adhere to certain operational and reporting requirements which could limit Goleta's business activity and increase expense. Management has been informed by the regulators that they do not believe Goleta is in full compliance with certain provisions of the Formal Agreement, including (i) implementing and demonstrating the effectiveness of its written risk management program, (ii) implementing a program to ensure compliance with consumer protection laws applicable to Goleta's short-term consumer loan program, (iii) accurately valuing, and documenting the valuations of, interest-only assets, servicing assets, deferred tax assets and deferred tax liabilities and (iv) ensuring compliance with applicable laws and regulations, particularly as related to the short-term consumer loan program. The failure to fully comply with such requirements could

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adversely affect the safety or soundness of Goleta. The OCC possesses broad powers to take corrective and other supervisory action and bring enforcement actions to resolve unsafe or unsound practices. The OCC has also expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make short-term consumer loans and believe this program subjects Goleta and the Company to significant strategic, reputational, compliance and transaction risks. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation - Formal Agreement With the OCC."

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MEMORANDUM OF UNDERSTANDING

In March 2000, Bancshares entered into an agreement (the "Memorandum of Understanding") with its principal regulator, the Federal Reserve Bank of San Francisco (the "Reserve Bank"). The Memorandum of Understanding requires the Company to maintain certain capital levels and adhere to certain operational and regulatory requirements which could limit the Company's business activity and increase expense. The Company believes that it is in substantial compliance with the Memorandum of Understanding. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation - Memorandum of Understanding With the Federal Reserve Bank."

SHORT-TERM CONSUMER LOAN PROGRAM

In 2001, the Company's short-term consumer lending program contributed approximately \$1.8 million to indirect and corporate overhead expenses after a provision for loan losses of approximately \$2.7 million. The OCC has expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make these loans and believe this program subjects Goleta and the Company to significant strategic, reputational, compliance and transaction risks. Some of these risks include: (i) reliance on the automated processes of ACE, (ii) the difficulty of monitoring transaction volume because of the geographic expanse and number of stores maintained by ACE, (iii) the difficulty of managing an adequate system to ensure compliance by ACE with consumer protection laws, (iv) the importance of this program to the Company's growth plans, (v) the adverse publicity arising from recent lawsuits associated with this program, and (vi) the risk of loss from such lawsuits. These risks could have a materially adverse effect on Goleta's and the Company's results of operations.

DEPENDENCE ON REAL ESTATE

Approximately 75% of the loan portfolio of the Company is secured by various forms of real estate, including residential and commercial real estate and manufactured housing. A decline in current economic conditions or rising interest rates could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, and the value of real estate and other collateral securing loans. The real estate securing the Company's loan portfolio is concentrated in California. If real estate values decline significantly, especially in California, higher vacancies and other factors could harm the financial condition of the Company's borrowers, the collateral for its loans will provide less security, and the Company would be more likely to suffer losses on defaulted loans.

RISKS ASSOCIATED WITH HIGH LOAN-TO-VALUE REAL ESTATE LOANS

The Company derives revenue from the origination and sale of high loan-to-value or "HLTV" second mortgage home loans. These loans may have loan-to-value ratios as high as 125%. The Company limits its exposure for losses due to defaults on HLTV loans by re-selling them in the secondary market. Interest and fees on some types of HLTV loans may be significantly higher than on more conventional home equity loans. As a result, HLTV lenders have received negative publicity and may be subject to future laws and regulations that limit rates and fees. Some of the secondary market purchasers of home equity loans have announced their intention to stop purchasing some types of HLTV loans. The loss of the secondary market for some types of HLTV loans, or an increasingly negative perception of HLTV lenders, could lead the Company to shift its marketing emphasis from very high interest rate and fee products to more conventional home loan products. These products could be less attractive to borrowers or less profitable for the Company.

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RELIANCE ON LOAN SALES FOR FUTURE EARNINGS

For the year ended December 31, 2001, the Company recognized \$6.6 million in gain on sale of loans to a limited number of secondary market investors. The Company plans to continue such sales. However, there is no assurance that these secondary market investors will continue to purchase loans at terms which are favorable to the Company. The withdrawal of these investors from the marketplace, and an inability to replace them with other similar investors, would have a materially adverse effect on the Company's financial condition and results of operations.

RISKS OF NATURAL DISASTERS

The Company's operations and much of the collateral for its real estate loans are concentrated in California, an area that experiences earthquakes, fires, floods and other natural disasters. The San Andreas Fault runs through the Company's service area. The Company has a disaster recovery plan, with off-site data processing facilities located in Scottsdale, Arizona. However, many of the Company's borrowers could suffer uninsured property damage, experience interruption of their businesses or lose their jobs after an earthquake or other natural disaster. Those borrowers might not be able to repay their loans, and the collateral for loans could decline significantly in value. Unlike a bank holding company with operations that are more geographically diversified, the Company is vulnerable to greater losses if an earthquake, fire, flood or other natural disaster occurs in the Company's service region.

INTEREST RATE CHANGES

A major portion of the Company's net income comes from its interest rate margin or "spread," which is the difference between the interest rates paid by the Company on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates the Company receives on interest-earning assets, such as loans extended to clients and securities held in the Company's investment portfolio. Interest rates are highly sensitive to many factors that are beyond the Company's control, such as inflation, recession, global economic disruptions, and unemployment. In addition to the effect on income from the Company's interest margin, changes in interest rates affect the demand for new loans, the credit profile of existing loans, the rates received on loans and securities and the rates Goleta must pay on deposits and borrowings. Changes in interest rates can also impact the speed of the repayment of sold loans. Goleta has recorded servicing and interest-only assets in connection with its sold loans. The faster the borrowers pay off these sold loans, the faster Goleta must amortize these financial assets as an expense. Under these circumstances, earnings are adversely affected by both the increased amortization expense and the loss of loan servicing income. Goleta has also recorded bond discount and issuance costs which must be amortized as an expense as the proceeds from the payment of securitized loans are used to pay down related bonds. High levels of prepayments of the securitized loans will accelerate the amortization of these expenses. Finally, changes in interest rates can adversely affect the ultimate sale price of certain fixed-rate loans held for sale.

COMPETITION

Competition may adversely affect Goleta's performance. The financial services business in Goleta's markets is highly competitive, and becoming more so due to changes in regulation, technology and the accelerating pace of consolidation among financial service providers. Other banks and specialty and diversified financial services companies, many of which are larger and have more capital than the Company, offer lending, leasing and other financial products to the

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Company's customer base. In some cases, competitors may offer a financial product that provides an alternative to one of the products the Company offers to its clients. When new competitors seek to enter one of the Company's markets, or when existing market participants seek to increase their market share, they sometimes undercut the pricing or credit terms prevalent in that market. Increasing levels of competition in the banking and financial services businesses may reduce market share or cause the prices the Company can charge for products and services to fall.

OPERATIONS RISKS

Goleta is subject to operations risks, including, but not limited to, data processing system failures and errors, customer or employee fraud and catastrophic failures resulting from terrorist acts or natural disasters. Goleta maintains a system of internal controls to mitigate against such

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occurrences and maintains insurance coverage for many of these risks. However, should an event occur that is not prevented or detected by Goleta's internal controls, or is uninsured or in excess of applicable insurance limits, it could have a significant adverse impact on the Company's business, financial condition or results of operations.

ADVERSE PUBLICITY AND LEGAL PROCEEDINGS

Goleta has been named in a number of lawsuits regarding its short-term consumer lending program. See "Item 3. Legal Proceedings." These lawsuits, in general, claim that Goleta has violated various state usury lending laws. In addition to the potential of loss associated with these lawsuits, Goleta has been, and is likely to continue to be, the subject of adverse publicity surrounding this business activity, with resulting harm to Goleta's reputation.

Adverse determinations in one or more of these actions could have a material adverse impact on the Company's financial condition or results of operations and continuation of the short-term consumer lending business, and could result in adverse actions by the regulatory agencies with authority over Goleta and the Company, including the OCC and the Board of Governors of the Federal Reserve System. The OCC has expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make short-term consumer loans and has implemented regulatory actions against two of these banks.

CURTAILMENT OF GOVERNMENT GUARANTEED LOAN PROGRAMS COULD CUT OFF AN IMPORTANT SEGMENT OF THE COMPANY'S BUSINESS

A major part of the Company's business consists of originating and selling government guaranteed loans, in particular those guaranteed by the Small Business Administration. From time to time, the government agencies that guarantee these loans reach their internal limits, and cease to guarantee loans for a stated time period. In addition, these agencies may change their rules for loans. Also, Congress may adopt legislation that would have the effect of discontinuing or changing the programs. Non-governmental programs could replace government programs for some borrowers, but the terms might not be equally acceptable. Therefore, if these changes occur, the volume of loans to small business, industrial and agricultural borrowers of the types that now qualify for government guaranteed loans could decline. Also, the profitability of these loans could decline.

BANK REGULATIONS COULD DISCOURAGE CHANGES IN THE COMPANY'S OWNERSHIP

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Bank regulations would delay and possibly discourage a potential acquirer who might have been willing to pay a premium price to amass a large block of common stock. That in turn could decrease the value of the Company's common stock and the price that you will receive if you sell your shares in the future. Before anyone can buy enough voting stock to exercise control over a bank holding company like Bancshares, bank regulators must approve the acquisition. A shareholder must apply for regulatory approval to own 10 percent or more of the Company's common stock, unless the shareholder can show that he or she will not actually exert control over the Company. In no case can a shareholder own more than 25 percent of the Company's common stock without applying for regulatory approval.

THE COMPANY DOES NOT EXPECT TO PAY DIVIDENDS

The Company does not intend to pay dividends on its common stock for the foreseeable future. Instead, it intends to reinvest earnings in its business. In addition, Bancshares would need the approval of the Reserve Bank (under the terms of the Company's Memorandum of Understanding) to pay dividends to its shareholders. One source of funds for the payment of dividends by Bancshares would be from dividends paid by Goleta to Bancshares. Goleta's ability to pay dividends to Bancshares is limited by California law, federal banking law, and the terms of Goleta's Formal Agreement with the OCC. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation - Formal Agreement With the OCC" and "- Memorandum of Understanding With the Federal Reserve Bank."

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THE PRICE OF THE COMPANY'S COMMON STOCK MAY CHANGE RAPIDLY AND SIGNIFICANTLY

The market price of the Company's common stock could change rapidly and significantly at any time. The market price of the Company's common stock has fluctuated in recent years. Between January 1, 2000 and December 31, 2001, the closing market price of its common stock ranged from a low of \$3.78 per share to a high of \$6.95 per share. Fluctuations may occur, among other reasons, in response to:

- Short-term or long-term operating results;
- Regulatory action or adverse publicity;
- Perceived value of the Company's loan portfolio;
- Trends in the Company's nonperforming assets or the nonperforming assets of other financial institutions;
- Announcements by competitors;
- Economic changes;
- General market conditions; or
- Legislative and regulatory changes.

The trading price of the Company's common stock may continue to be subject to wide fluctuations in response to the factors set forth above and other factors, many of which are beyond the Company's control. The stock market in recent years has experienced extreme price and trading volume fluctuations that often have been unrelated or disproportionate to the operating performance of individual companies. The Company believes that investors should consider the likelihood of these market fluctuations before investing in the Company's common

stock.

SECURITY RISKS RELATED TO ONLINE BANKING SERVICES

Goleta offers online banking services to its clients and other services on its Web site. The secure transmission of confidential information over the Internet is essential to maintain clients' confidence in the Company's online services. Advances in computer capabilities, new discoveries or other developments could result in a compromise or breach of the technology used by us to protect client transaction data. Although the Company has developed systems and processes that are designed to prevent security breaches, failure to mitigate breaches of security could expose the Company to liability or inhibit its ability to expand online services, which would adversely affect its financial condition. Financial services customers are generally sensitive to security and privacy on the Internet and any publicized security problems could inhibit the growth of the Internet in general as a means of conducting commercial transactions. The Company's ability to provide financial services over the Internet would be severely impeded if clients became unwilling to transmit confidential information online. As a result, the Company's operations and financial condition could be adversely affected.

THE COMPANY DEPENDS ON KEY EMPLOYEES

If the Company lost key employees temporarily or permanently, the Company's business could suffer material harm. The Company could be particularly hurt if key employees went to work for competitors. The Company's future success depends on the continued contributions of existing senior management personnel, including the President and Chief Operating Officer of Bancshares, Stephen W. Haley, and the President of Goleta, Lynda Nahra.

ENVIRONMENTAL LAWS COULD FORCE THE COMPANY TO PAY FOR ENVIRONMENTAL PROBLEMS

When a borrower defaults on a loan secured by real property, the Company often purchases the property in foreclosure or accepts a deed to the property surrendered by the borrower. The Company may also take over the management of

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commercial properties whose owners have defaulted on loans. While Goleta has guidelines intended to exclude properties with an unreasonable risk of contamination, hazardous substances may exist on some of the properties that Goleta owns, manages or occupies. The Company faces the risk that environmental laws could force it to clean up the properties at the Company's expense. It may cost much more to clean a property than the property is worth. The Company could also be liable for pollution generated by a borrower's operations if the Company took a role in managing those operations after a default. The Company may also find it difficult or impossible to resell contaminated properties.

COMPETITION AND SERVICE AREA

The financial services industry is highly competitive with respect to both loans and deposits. Overall, the industry is dominated by a relatively small number of major banks with many offices operating over wide geographic areas. Some of the major commercial banks operating in the Company's service areas offer certain services, which are not offered directly by the Company or any of its subsidiaries. Some of these services include: in-depth trust and investment services, international banking, and due to their size, a substantially higher lending limit. To help offset the numerous branch offices of banks, thrifts, and credit unions, as well as competition from mortgage brokers, insurance companies, credit card companies, and brokerage houses within the Company's

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service areas, the Company, through its subsidiaries, has established loan production offices in Sacramento, Fresno, San Francisco, Santa Maria, Santa Barbara, Orange County, and Ventura, California; Nevada; Georgia; Florida; Oregon; Washington; Columbia, South Carolina; Tennessee and Colorado. The Company's online capabilities allow it to support these offices from its main computer center in Goleta, California. Part of the Company's strategy is to establish loan production offices in areas where there is high demand for the loan products that it originates.

The Company uses the flexibility of its independent status to compete for loans and deposits within its primary service area. Management has established highly personalized banking relationships with the Company's customers and is attuned and responsive to their financial and service requirements. The Company emphasizes its experienced management and trained staff to handle the specialized banking needs of its customers. In the event there are customers whose loan demands exceed the Company's lending limits, the Company works to arrange for such loans on a participation basis with other financial institutions. The Company also assists those customers requiring specialized services not offered by the Company to obtain such services through correspondent institutions.

EMPLOYEES

As of December 31, 2001, the Company employed 230 people. The Company's employees are not represented by a union or covered by a collective bargaining agreement. Management of the Company believes that, in general, its employee relations are good.

ITEM 2. DESCRIPTION OF PROPERTY

The Company owns the Goleta full-service branch located at 5827 Hollister Avenue, Goleta, California. It consists of a 4,000 square-foot facility, and a separate 400 square-foot building which currently is subleased to a third party.

The Company leases a 20,684 square-foot corporate office located at 445 Pine Avenue, Goleta, California. The lease is for a term expiring March 31, 2007, with a current monthly rent of \$26,889. The lease also provides the Company with two options of five years each, to extend the lease. This facility houses the Company's corporate offices, comprised of various departments, including finance, data processing, compliance, human resources, electronic business services, special assets, operations and loan collection.

The Company also leases 18 additional office spaces ranging in size from 190 to 8,200 square feet with lease terms expiring in one month up to a maximum of 5 years. Monthly lease expense per premise ranges from \$225 to \$31,364. The Company currently subleases two of the spaces to third parties. The Company's total occupancy expense, including depreciation, for the year ended December 31, 2001 was \$3,625,355. Management believes that its existing facilities are adequate for its present purposes.

The more significant leases include the following:

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The Company leases, under two separate leases, approximately 3,744 square feet of office space located at 3891 State Street, Santa Barbara, California. The leases are for terms expiring April 30, 2002 and April 30, 2003, with an approximate rent of \$7,890 per month. This facility houses the Retail and Wholesale Mortgage Lending departments of the Company.

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The Company leases approximately 3,431 square feet of office space located at 1463 South Victoria Avenue, Ventura, California. The lease is for a term expiring July 20, 2002, with an approximate rent of \$5,555 per month. This facility houses the Ventura branch office of Goleta, as well as the Ventura mortgage, SBA, and accounts receivable financing departments of the Company.

The Company leases approximately 7,570 square feet of space located at 681 South Parker Street Suite 350, Orange, California. The lease is for a term expiring September 30, 2003, with a current monthly rent of \$9,463 per month. This facility houses the Orange County loan production office of the Company.

The Company leases approximately 6,380 square feet of space located at 5383 Hollister Avenue, 2nd Floor, Goleta, California. The lease is for a term expiring November 30, 2002, with an approximate rent of \$8,932 per month. On May 18, 2000, the Company sublet the entire space. The sublease does not provide an option for the sublessee to extend the sublease.

The Company leases three suites in an office building at 5638 Hollister Avenue, Goleta, California. The leases are for terms expiring May 31, 2003, with a current monthly rent of \$11,177 per month for all three suites. The leases also provide the Company with two additional consecutive options of three years each to extend the leases. The suites consist of approximately 8,200 square feet of office space. The Company sublet these suites to an independent third party for a term commencing May 1, 2000 and expiring May 31, 2003. The sublease does not provide the sublessee an option to extend the sublease.

ITEM 3. LEGAL PROCEEDINGS

The following summarizes the Company's significant legal proceedings.

FORMER ACCOUNTANTS

In October 2000, the Company filed a lawsuit against its former accountants alleging deficient consulting and audit services that led to the restatement of the Company's 1998 financial statements and ultimately to an impairment of capital. In April 2001, the Company settled the lawsuit and received \$7 million in cash. The proceeds are reflected as "other income" for financial reporting purposes. The Company also incurred \$2,392,000 in legal and professional fees in connection with the litigation which are included as other expenses.

SHORT-TERM CONSUMER LENDING

Goleta makes short-term consumer loans ("Bank Loans") using certain marketing and servicing assistance of ACE at almost all of ACE's retail locations pursuant to the terms of a Master Loan Agency Agreement between ACE and Goleta (the "Goleta Agreement"). A number of lawsuits and state regulatory proceedings have been filed or initiated against Goleta and/or ACE regarding the Bank Loans.

A key issue in the existing lawsuits and state regulatory proceedings concerning the Bank Loans is whether Goleta or ACE is properly regarded as the lender. Goleta and ACE maintain that, as provided by the legal documentation and marketing materials for the Bank Loans, Goleta is the lender and that, because Goleta is a national bank located in California, the Bank Loans, including the interest that may legally be charged, should be governed by federal and California law. The opposing parties in most of these lawsuits and regulatory proceedings, however, maintain that ACE should be regarded as the lender, because of the services it renders to Goleta under the Goleta Agreement and ACE's purchase of participation interests in the Bank Loans, and that the Bank

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Loans, including interest that may legally be charged, should be governed by the laws of the respective states in which the borrowers reside. If ACE were held to be the lender, then the interest charged for the Bank Loans would violate most of the applicable states' usury laws, which impose maximum rates of

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interest or finance charges that a non-bank lender may charge. The consequences to the Company of such a holding in any lawsuit or regulatory proceeding would depend on the applicable state's usury and consumer-protection laws and on the basis for a finding of violation of those laws. Those consequences could include the Company's obligation to refund interest collected on the alleged illegal Bank Loans, to refund the principal amount of the alleged illegal Bank Loans, to pay treble or other multiple damages, to pay monetary penalties specified by statute, and to cease offering the Bank Loans (at least as theretofore offered). Regarding each lawsuit, that amount would depend upon proof of the allegations, the number or the amount of the loan-related transactions during relevant time periods, and (for certain of the claims) proof of actual damages sustained by the plaintiffs. The Goleta Agreement generally provides that ACE will be liable for 90% to 95% of the costs and monetary damages, if any, that would be paid to claimants in these actions and Goleta will generally be liable for 5% to 10% of such costs and/or monetary damages. However, if the Goleta Agreement is invalid or unenforceable, or if ACE is unable to pay, Goleta may be liable for up to the full amount of any and all claims.

Adverse determinations in one or more of these actions could have a material adverse impact on the Company's financial condition or results of operations and continuation of the short-term consumer lending business, and could result in adverse actions by the regulatory agencies with authority over Goleta and the Company, including the OCC and the Board of Governors of the Federal Reserve System. The OCC has expressed strong reservations about Goleta and other national banks entering into arrangements with third parties to make short-term consumer loans and has implemented regulatory actions against two of these banks.

The following is a summary of the significant lawsuits relating to the Bank Loans. Most of the following cases are in their early stages and the outcome of any litigation is inherently uncertain. Based on advice from legal counsel, management has no reason to believe it probable that the resolution of these matters will have a material adverse impact on the Company's financial condition or results of operations. However, it is possible that adverse determinations in one or more of these actions could ultimately have a material adverse financial impact on the Company and could also result in adverse actions by the regulatory agencies with authority over Goleta.

1. JENNAFER LONG V. ACE CASH EXPRESS, INC. This lawsuit, originally filed

against ACE (and not Goleta) in Florida state court on behalf of a putative class of Florida borrowers, alleges that the Bank Loans at ACE's Florida locations should be deemed to be made by ACE rather than by Goleta and, therefore, that those Bank Loans violate Florida usury laws and Florida statutory prohibitions against misrepresentations and deceptive practices. The plaintiff seeks an unspecified amount of damages, including an amount equal to all interest charged on the Bank Loans made in Florida, the plaintiff's attorneys' fees, and court costs. ACE's earlier attempt to remove this case to federal court was unsuccessful and Goleta subsequently intervened as a defendant in the lawsuit. ACE and Goleta moved to dismiss the lawsuit on the ground that, under governing federal law, Goleta is entitled to charge interest on the Bank Loans at the rates permitted under the law of the State of California, where Goleta is located. However, the court

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denied the motion to dismiss.

2. NOTICE FROM OHIO DEPARTMENT OF COMMERCE. In July 2001, the

Superintendent of the Ohio Division of Financial Institutions (the "Ohio Superintendent") delivered to ACE a Notice of Intent to Issue Cease and Desist Order and Notice of Opportunity for Hearing. This Notice asserts that ACE, not Goleta, is the lender of the Bank Loans made in Ohio; that those Bank Loans violate the Ohio Small Loan Act and are void; that all finance charges and interest received from those Bank Loans, as well as the outstanding principal of all such existing Bank Loans, should be forfeited; and that ACE should be ordered to cease violating the Ohio Small Loan Act. In response to the Notice, Goleta initiated a lawsuit in federal court against the Ohio Superintendent seeking declaratory and injunctive relief against the Ohio Superintendent's pursuit of a regulatory action against ACE. The thrust of Goleta's action is that, under federal law, the interest charges on the Bank Loans are governed by California and not Ohio law. In response to this federal court lawsuit, the Ohio Superintendent agreed to suspend the Ohio regulatory proceeding against ACE until the federal court rules on Goleta's complaint. The Ohio Superintendent has moved to dismiss Goleta's lawsuit on a series of jurisdictional and procedural grounds. Goleta's motion for a preliminary injunction and the Ohio Superintendent's motion to dismiss have been largely briefed but no hearing has yet been scheduled.

3. ORDER TO SHOW CAUSE FROM MARYLAND COMMISSIONER OF FINANCIAL

REGULATION. In December 2001, ACE settled a regulatory proceeding initiated against it in July 2001 by the Maryland Commissioner of

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Financial Regulation. Among other things, the settlement agreement provides for ACE to pay a total of \$164,000 of penalties for failing to maintain requisite licenses in connection with its activities regarding Maryland Bank Loans. By agreement with ACE, Goleta did not contribute to the costs or penalties in connection with this regulatory proceeding.

4. STATE OF COLORADO, EX REL. KEN SALAZAR, ATTORNEY GENERAL FOR THE STATE

OF COLORADO, AND LAURA E. UDIS, ADMINISTRATOR, UNIFORM CONSUMER CREDIT

CODE V. ACE CASH EXPRESS, INC. This lawsuit regarding Bank Loans

offered and made at ACE's locations in Colorado was filed on behalf of the State of Colorado against ACE (and not Goleta) in a Colorado state court in Denver, Colorado in July 2001. The complaint alleges that these Bank Loans are "deferred deposit" loans subject to the Colorado Deferred Deposit Loan Act (the "DDLA"), which is part of the Colorado Uniform Consumer Credit Code ("UCCC"); that the second and third renewals of the Bank Loans violate the DDLA (which purports to permit only one renewal of deferred deposit loans at the interest rates permitted by the DDLA); and that ACE is required to maintain a license as a "supervised lender" in Colorado because of its activities in connection with the Bank Loans. ACE voluntarily relinquished its license as a supervised lender in Colorado in December 2000.

In its complaint, the State of Colorado seeks various remedies against ACE under the Colorado UCCC and other Colorado law, including the

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refund to borrowers of all finance charges or interest received on all Bank Loans made in Colorado while ACE was unlicensed; the refund to borrowers of all finance charges or interest received on all second and third renewals of the Bank Loans since July 1, 2000, the effective date of the DDLA; and a penalty (to be determined by the court) equal to the greater of either all of the finance charges or interest received or up to ten times the amount of all excess finance charges or interest received. The complaint also seeks an injunction prohibiting ACE from continuing to engage in activities regarding the Bank Loans in Colorado without a supervised lender license.

In or about July 2001, the State of Colorado filed a motion for a preliminary injunction to require ACE to cease all activities regarding the Bank Loans in Colorado immediately, subject to an expedited hearing on the legality of those activities. In August 2001, ACE removed this lawsuit to federal court. However, the case was remanded to state court in January 2002. Arguments available to ACE in defending the lawsuit include, without limitation, that: (1) the Bank Loans are not deferred deposit loans under the DDLA; (2) the State is not entitled to the remedies it is seeking for the alleged licensing violations; and (3) the limits regarding loan renewals imposed by the DDLA are preempted by federal law. Though ACE does not admit that it is required to obtain a supervised lender license under the Colorado UCCC, it has submitted applications for re-licensure and has begun discussions with the State regarding resolution of the State's licensing claims. Subject to approval of the ACE Board of Directors and negotiation and execution of a definitive settlement agreement, ACE and the State have informally agreed to a settlement of this lawsuit under which ACE would make payments to Colorado borrowers in exchange for releases; ACE would be retroactively licensed to make or broker deferred deposit loans under the Colorado UCCC; and ACE would commence making loans directly to Colorado borrowers rather than brokering Bank Loans on behalf of Goleta. ACE has agreed with Goleta that ACE will be solely liable for all costs and payments in connection with this litigation.

5. RUFUS PATRICIA BROWN V. ACE CASH EXPRESS, INC. ET AL. This lawsuit, on -----

behalf of a punitive class of borrowers who obtained their Bank Loans at ACE locations in Maryland, was filed in August 2001 in the Circuit Court for Baltimore City, Maryland. While ACE removed the case to federal court, the federal court remanded the case to state court. Goleta subsequently intervened as a defendant in the case. In this case, the plaintiff alleges that the Bank Loans violate Maryland usury laws, the Maryland Consumer Loan Law, the Maryland Credit Services Businesses Act, and the Maryland Consumer Protection Act and are unconscionable under Maryland law. The plaintiff seeks relief of various kinds, including a permanent injunction against any further alleged illegal activities; an award of three times excess interest charges on the Bank Loans; the return of principal on the Bank Loans; and court costs and attorneys' fees and expenses. The defendants have answered the complaint and discovery has commenced. However, this case remains in its preliminary stages at present.

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6. BEVERLY PURDIE V. ACE CASH EXPRESS, INC. ET AL. This lawsuit was filed -----

in September 2001 in the United States District Court for the Northern District of Texas and names Goleta, ACE and certain ACE executives as defendants. In the complaint, the plaintiff purports to represent a

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class of all consumers in the United States who obtained Bank Loans. The plaintiff alleges that the Bank Loans and defendants' activities in connection therewith violate the federal Racketeering and Corrupt Organizations Act ("RICO") and the laws and regulations of various states regarding usury, deceptive trade practices (including the Texas Deceptive Trade Practices Act), and other consumer protections. The plaintiff seeks relief of various kinds, including a permanent injunction against collecting any moneys in connection with the Bank Loans; restitution of all amounts paid to the defendants; damages equal to three times the amount of all fees and interests paid by the class; punitive damages of at least \$250 million; the plaintiff's attorneys' fees; and court costs. The defendants have moved to dismiss the complaint on the grounds that the RICO claims are deficient as a matter of law and that, after dismissing the RICO claims, the court should not retain jurisdiction of the remaining state-law claims.

7. VONNIE T. HUDSON V. ACE CASH EXPRESS, INC. ET AL. This lawsuit on

behalf of borrowers who received Bank Loans offered and made at ACE's locations in Indiana was filed in September 2001 in federal court for the Southern District of Indiana. The defendants include Goleta, ACE and certain ACE executives. The plaintiff alleges that the Bank Loans violate the Indiana Uniform Consumer Credit Code and the Indiana "loansharking" statute, because the interest exceeds the finance charges permitted by those statutes; that the Bank Loans violate the federal Truth in Lending Act ("TILA") and the Indiana UCCC because the disclosures to borrowers do not comply with the disclosure requirements of those laws; and that the Bank Loans also violate RICO. The plaintiff seeks relief of various kinds, including: (a) for the members of the class of plaintiffs who were allegedly charged excessive interest, an order declaring the Bank Loans "void," the refund of all finance charges or interest paid by them in excess of the maximum finance charges permitted under the Indiana UCCC, and a penalty (to be determined by the court) in a maximum amount equal to the greater of either all of the finance charges or interest received from them or up to ten times the amount of all excess finance charges or interest received from them; (b) for the members of the class of plaintiffs who allegedly did not receive proper disclosures under TILA and the Indiana UCCC, statutory damages of \$500,000 for violations of each statute; (c) for the members of the class of plaintiffs allegedly damaged because of RICO violations, an amount equal to three times those damages; and (d) the plaintiff's attorneys' fees and court costs. The defendants have moved to dismiss this lawsuit on the ground that the Bank Loans are made by Goleta and not ACE and, accordingly, the interest charges are governed by federal and California law and not Indiana law.

8. GOLETA NATIONAL BANK AND ACE CASH EXPRESS, INC. V. HAL D. LINGERFELT,

IN HIS OFFICIAL CAPACITY AS THE COMMISSIONER OF BANKS OF NORTH

CAROLINA, ET AL. In January 2002, Goleta and ACE instituted suit

against defendants for declaratory and injunctive relief with respect to defendants' threatened initiation of state court proceedings against ACE. Goleta and ACE allege that defendants threatened to impair Goleta's federally created rights to make Bank Loans to North Carolina residents, to charge the interest allowed by the laws of California, where Goleta is located, to obtain assistance from ACE in making its Bank Loans and to sell interests in its Bank Loans. The State has moved to dismiss this lawsuit on the ground that the federal court does not have the power to hear the case. Also in January 2002,

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immediately after the filing of the Goleta/ACE lawsuit, the State of North Carolina initiated the threatened lawsuit in North Carolina state court against ACE (but not Goleta), alleging that ACE and not Goleta is the lender and that the Bank Loans accordingly are usurious and alleging in addition or in the alternative that ACE has violated North Carolina loan broker and check cashing statutes. ACE removed the State lawsuit to federal court and the State moved to remand the case to state court. Answers have been filed in both cases.

OTHER LITIGATION

The Company is involved in various other litigation of a routine nature which is being handled and defended in the ordinary course of the Company's business. In the opinion of management, based in part on consultation with legal counsel, the resolution of these other litigation matters will not have a material impact on the Company's financial position.

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

None.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER

MATTERS

The following table sets forth the high and low closing sales prices on a per share basis for the common stock as reported by the Nasdaq National Market for the period indicated:

| | | Common Stock | |
|------|----------------|--------------|--------|
| | | Low | High |
| | | ----- | ----- |
| 2002 | First Quarter | \$3.95 | \$6.07 |
| 2001 | First Quarter | \$3.78 | \$5.50 |
| | Second Quarter | 3.95 | 6.25 |
| | Third Quarter | 6.10 | 6.95 |
| | Fourth Quarter | 5.50 | 6.50 |
| 2000 | First Quarter | \$5.50 | \$8.00 |
| | Second Quarter | 5.38 | 6.88 |
| | Third Quarter | 5.13 | 6.25 |
| | Fourth Quarter | 3.38 | 5.25 |

On April 12, 2002, the last reported sale price per share for the Company's common stock was \$4.55.

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The Company had 514 shareholders of record of its common stock as of December 31, 2001.

No cash dividends have been paid to shareholders during the past two years, and the Company does not expect to declare cash dividends in the foreseeable future. The payment of dividends is within the discretion of the Company's Board of Directors and will depend upon, among other things, the Company's earnings, financial condition, capital requirements and general business condition. The payment of dividends requires the approval of the Reserve Bank under the Company's Memorandum of Understanding. One source of funds for the payment of dividends by Bancshares would be from dividends paid by Goleta to Bancshares. Goleta's ability to pay dividends to Bancshares is limited by California law, federal banking law, and the terms of Goleta's Formal Agreement with the OCC. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Supervision and Regulation - Limitations on Dividend Payments," "- Formal Agreement With the OCC" and "-Memorandum of Understanding With the Federal Reserve Bank."

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ITEM 6. SELECTED FINANCIAL DATA

SUMMARY OF OPERATIONS

The following summary of the Company's consolidated financial condition and results of operations, as of and for the years ended December 31, 2001, 2000, 1999, 1998 and 1997, should be read in conjunction with the consolidated financial statements and the related notes included elsewhere in this report. The notes to the consolidated financial statements include a summary of significant accounting policies.

| | December 31, | | | |
|---|--------------|-----------|------------|-----------|
| (Dollars in thousands, except per share data) | 2001 | 2000 | 1999 | 1998 |
| Interest income | \$ 40,794 | \$ 51,781 | \$ 48,495 | \$ 15,279 |
| Interest expense | 19,967 | 26,060 | 25,145 | 6,317 |
| Net interest income | 20,827 | 25,721 | 23,350 | 8,962 |
| Provision for loan losses | 11,880 | 6,794 | 6,133 | 1,759 |
| Net interest income after provision for loan losses | 8,947 | 18,927 | 17,217 | 7,203 |
| Other operating income | 22,171 | 16,283 | 11,021 | 11,022 |
| Other operating expense | 32,377 | 29,975 | 30,506 | 17,482 |
| (Loss) income before income taxes | (1,259) | 5,235 | (2,268) | 743 |
| (Benefit) provision for income taxes | (1,281) | 2,538 | (622) | 289 |
| Net income (loss) | \$ 22 | \$ 2,697 | \$ (1,646) | \$ 454 |
| Income (loss) per common share - Basic | \$ 0.00 | \$ 0.44 | \$ (0.30) | \$ 0.12 |
| Number of shares used in income (loss) per share calculation - Basic (1) | 5,947,658 | 6,017,216 | 5,494,217 | 3,767,607 |

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| | | | | |
|---|------------|------------|------------|------------|
| Income (loss) per common share - Diluted | \$ 0.00 | \$ 0.43 | \$ (0.30) | \$ 0.12 |
| Number of shares used in income (loss) per share calculation - Diluted (1) | 5,998,003 | 6,233,245 | 5,494,217 | 3,941,749 |
| Net loans | \$ 260,955 | \$ 329,265 | \$ 451,664 | \$ 247,411 |
| Total assets | 323,863 | 405,255 | 523,847 | 327,569 |
| Deposits | 196,166 | 228,720 | 313,131 | 223,853 |
| Total liabilities | 290,506 | 369,221 | 489,915 | 298,448 |
| Total stockholders' equity | 33,357 | 36,035 | 33,932 | 29,121 |