NEW CENTURY FINANCIAL CORP
Form 10-Q
August 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006.

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: 001-32314
NEW CENTURY FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND	**56-2451736**
(State of Incorporation)	*(I.R.S. Employer Identification No.)*

18400 VON KARMAN, SUITE 1000,
IRVINE, CALIFORNIA 92612
(Address of principal executive offices) (Zip Code)
(949) 440-7030
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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 Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non accelerated filer o

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

As of July 31, 2006, the registrant had 56,117,164 shares of common stock outstanding.

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES
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Certain information included in this Quarterly Report on Form 10-Q may include forward-looking statements under federal securities laws, and the company intends that such forward-looking statements be subject to the safe-harbor created thereby. Such statements include, without limitation, (i) the company s business strategies; (ii) the company s expectations with respect to market trends; (iii) the company s projected sources and uses of funds from operations; (iv) the company s potential liability with respect to its legal proceedings; (v) the potential effects of proposed legislation and regulatory actions; (vi) the company s expectation that the adoption of SFAS 155 will not have a material impact on the company s financial statements; (vii) the company s expectation that the initial adoption of SFAS 156 will have an immaterial impact on the Company s retained earnings; (viii) the company s expectation that the initial adoption of FIN 48, the impact of its adoption will not have a significant impact on the company s financial statements; (ix) the company s estimates it uses to determine the value of its residual assets, including the future rate of prepayments, prepayment penalties it will receive, delinquencies, defaults and default loss severity as they affect the amount and timing of estimated cash flows; (x) the company s estimates with respect to average cumulative losses as a percentage of the original principal balance of mortgage loans for adjustable-rate and fixed-rate securities; (xi) the company s estimates with respect to its prepayments; (xii) the company s estimates with respect to the prepayment characteristics of its mortgage loans; (xiii) the company s expectations with respect to the performance of the mortgage loans held in the securitization trusts and the ability of the company to realize the current estimated fair value of its Residual; (xiv) the company s expectations with respect to renewing or extending its various credit facilities; (xv) the company s expectation that it may designate its interest rate swap contracts as hedge instruments in the future; (xvi) the company s expectation that the $29.2 million deferred gain that it recorded at June 30, 2006 will be recognized in the third quarter of 2006 due to the timing of related expired Euro Dollar futures contracts, which hedge three months forward; (xvii) the company s expectation that it will reclassify an additional $20.3 million from OCI into earnings during the remainder of 2006 related to expiring contracts; (xviii) the company s expectation that the remaining OCI will be reclassified into earnings by September 2009; (xix) the company s expectation that the earnings attributable to the REIT will not be taxable due to the benefit of the REIT s dividend paid deduction; (xx) the company s estimates with respect to the fair value of its stock options; (xxi) the company s expectation that its decisions regarding secondary marketing transactions in 2006 will be influenced by market conditions and the company s ability to access external sources of capital; (xxii) the company s current intention that it will not complete any securitizations structured as sales in 2006; (xxiii) the company s expectation that a significant source of its revenue will continue to be interest income generated from its portfolio of mortgage loans held by the company s REIT and its taxable REIT subsidiaries; (xxiv) the company s expectation that it will continue to generate revenue through its taxable REIT subsidiaries from the sale of loans, servicing income and loan origination fees; (xxv) the company s expectation that the primary components of its expenses will be (a) interest expense on its credit facilities, securitizations and other borrowings, (b) general and administrative expenses and (c) payroll and related expenses arising from its origination and servicing businesses; (xxvi) the company s efforts to continue to reduce its costs to remain efficient even if loan origination volume declines; (xxvii) the company s focus to enhance the net execution of its whole loan sales and its cost-cutting strategies; (xxviii) the company s current strategy to maintain interest rates at a level that will achieve its desired operating margins, potentially resulting in a decrease in loan production volume as a result of higher interest rates on the mortgages the company originates; (xxix) the company s expectation that its non-prime gain on sale margins will continue their favorable trend; (xxx) the company s expectation that its gain on sale execution will be negatively impacted on a go-forward basis because its whole loan sale prices will decrease by as much as 10 basis points as a result of the recent changes to Standard and Poor s LEVELs Model; (xxxi) the company s belief that the lower initial payment requirements of pay-option loans may increase the credit risk inherent in its loans held for sale; (xxxii) the company s expectation that as its portfolio of mortgage loans held for investment seasons, certain loans will become uncollectible; (xxxiii) the company s expectation that as the size of its portfolio of loans increases, the number of uncollectible mortgage loans, and related charge-offs, will increase; (xxxiv) the company s beliefs, estimates and assumptions with respect to its critical accounting policies; (xxxv) the company s estimates and assumptions relating to the interest rate environment, the economic environment, secondary market conditions and the performance of the loans underlying its residual assets and mortgage loans held for investment; (xxxvi) the company s use of a prepayment curve to estimate the prepayment characteristics of its mortgage

loans; (xxxvii) the company s allowance for repurchase losses; (xxxviii) the company s right to terminate, reduce or increase the size of its stock purchase program at any time; (xxxix) the company s principal strategies to effectively manage its liquidity and capital; (xl) the company s target levels of liquidity and capital; (xli) the company s expectation that it will continue to manage the percentage of loans sold through whole loan sales transactions, off-balance sheet securitizations including the use of NIM structures as appropriate, and securitizations structured as financings, giving consideration to whole loan prices, the amount of cash required to finance securitizations structured as financings, the expected returns on such securitizations and REIT qualification requirements; (xlii) the company s intention to access the capital markets when appropriate to support its business operations; (xliii) the company s intention to execute its stock repurchase program while maintaining its targeted cash and liquidity levels; (xliv) the company s expectation that its liquidity, credit facilities and capital resources will be sufficient to fund its operations for the foreseeable future, while enabling the company to maintain its qualification as a REIT under the requirements of the Code; and (xlv) the company s expectation that any future declarations of dividends on its common stock will be subject to its earnings, financial position, capital requirements, contractual restrictions and other relevant factors.

The company cautions that these statements are qualified by important factors that could cause its actual results to differ materially from expected results in the forward-looking statements. Such factors include, but are not limited to, (i) the condition of the U.S. economy and financial system; (ii) the interest rate environment; (iii) the effect of increasing competition in the company s sector; (iv) the condition of the markets for whole loans and mortgage-backed securities; (v) the stability of residential property values; (vi) the company s ability to comply with the requirements applicable to REITs; (vii) the company s ability to increase its portfolio income; (viii) the company s ability to continue to maintain low loan acquisition costs; (ix) the potential effect of new state or federal laws and regulations; (x) the company s ability to maintain adequate credit facilities to finance its business; (xi) the outcome of litigation or regulatory actions pending against the company; (xii) the company s ability to adequately hedge its residual values, cash flows and fair values; (xiii) the accuracy of the assumptions regarding the company s repurchase allowance and Residual valuations, prepayment speeds and loan loss allowance; (xiv) the ability to finalize forward sale commitments; (xv) the ability to deliver loans in accordance with the terms of forward sale commitments; (xvi) the assumptions underlying the company s risk management practices; and (xvii) the ability of the company s servicing platform to maintain high performance standards. Additional information on these and other factors is contained in the company s Annual Report on Form 10-K for the year ended December 31, 2005 and the company s other periodic filings with the Securities and Exchange Commission.

The company assumes no, and hereby disclaims any, obligation to update the forward-looking statements contained in this Quarterly Report on Form 10-Q.

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
June 30, 2006 and December 31, 2005
(Dollars in thousands)

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 380,847	503,723
Restricted cash	717,201	726,697
Mortgage loans held for sale at lower of cost or market	9,303,086	7,825,175
Mortgage loans held for investment, net of allowance of $209,889 and $198,131, respectively	15,905,636	16,143,865
Residual interests in securitizations held-for-trading	209,335	234,930
Mortgage servicing assets	42,096	69,315
Accrued interest receivable	113,920	101,945
Income taxes, net	65,520	80,823
Office property and equipment, net	89,384	86,886
Goodwill	95,792	92,980
Prepaid expenses and other assets	402,582	280,751
Total assets	$ 27,325,399	26,147,090
LIABILITIES AND STOCKHOLDERS EQUITY		
Credit facilities on mortgage loans held for sale	$ 8,786,300	7,439,685
Financing on mortgage loans held for investment, net	15,794,335	16,045,459
Accounts payable and accrued liabilities	578,475	508,163
Convertible senior notes, net		4,943
Notes payable	27,984	39,140
Total liabilities	25,187,094	24,037,390
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value. Authorized 25,000,000 shares at June 30, 2006 and 10,000,000 shares at December 31, 2005; issued and outstanding 4,500,000 shares at June 30, 2006 and December 31, 2005	45	45
Common stock, $0.01 par value. Authorized 300,000,000 shares at June 30, 2006 and December 31, 2005; issued and outstanding 56,076,773 and 55,723,267 shares at June 30, 2006 and December 31, 2005, respectively	561	557
Additional paid-in capital	1,221,929	1,234,362
Accumulated other comprehensive income	83,040	61,045
Retained earnings	832,730	828,270

	2,138,305	2,124,279
Deferred compensation costs		(14,579)
Total stockholders equity	2,138,305	2,109,700
Total liabilities and stockholders equity	$ 27,325,399	26,147,090

See accompanying notes to unaudited condensed consolidated financial statements.

NEW CENTURY FINANCIAL CORPORATION SUBSIDIARIES
Condensed Consolidated Statements of Earnings
(Dollars in thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Interest income	$ 501,114	420,861	964,116	751,932
Interest expense	(361,111)	(218,555)	(644,324)	(380,636)
Net interest income	140,003	202,306	319,792	371,296
Provision for losses on mortgage loans held for investment	(32,325)	(36,875)	(60,150)	(67,113)
Net interest income after provision for losses	107,678	165,431	259,642	304,183
Other operating income:				
Gain on sale of mortgage loans	195,160	110,604	324,687	233,556
Servicing income	14,012	6,631	29,654	13,353
Other income	24,961	3,398	39,592	7,271
Total other operating income	234,133	120,633	393,933	254,180
Operating expenses:				
Personnel	126,922	119,961	243,643	231,683
General and administrative	55,113	42,324	112,588	84,099
Advertising and promotion	13,851	20,711	26,554	40,543
Professional services	11,103	9,677	20,293	17,483
Total operating expenses	206,989	192,673	403,078	373,808
Earnings before income taxes	134,822	93,391	250,497	184,555
Income tax expense (benefit)	29,279	(1,688)	41,219	4,716
Net earnings	105,543	95,079	209,278	179,839
Dividends paid on preferred stock	2,567	285	5,133	285
Net earnings available to common stockholders	$ 102,976	94,794	204,145	179,554
Basic earnings per share	$ 1.85	1.71	3.67	3.26
Diluted earnings per share	$ 1.81	1.65	3.59	3.13
Basic weighted average shares outstanding	55,784,919	55,376,001	55,652,977	55,079,377
Diluted weighted average shares outstanding	56,935,553	57,396,098	56,816,074	57,331,721

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income
(Dollars in thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Net earnings	$ 105,543	95,079	209,278	179,839
Net unrealized gains (losses) on derivative instruments designated as hedges	15,135	(95,520)	20,396	(22,607)
Reclassification adjustment into earnings for derivative instruments	812	2,227	1,605	7,488
Tax effect	77	1,488	(6)	(849)
Comprehensive income	$ 121,567	3,274	231,273	163,871

See accompanying notes to unaudited condensed consolidated financial statements.

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
Year Ended December 31, 2005 and Six Months Ended June 30, 2006
(In thousands, except per share amounts)

	Preferred Shares Outstanding	Preferred Stock Amount	Common Shares Outstanding	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Deferred Compensation	Total
Balance at December 31, 2004			54,703	547	1,108,590	(4,700)	781,627	(7,499)	1,878,565
Proceeds from issuance of common stock			1,880	19	26,440				26,459
Proceeds from issuance of preferred stock	4,500	45			108,619				108,664
Repurchases and cancellation of treasury stock			(879)	(9)	(29,465)				(29,474)
Cancelled shares related to stock options			(244)	(2)	(12,414)				(12,416)
Conversion of convertible senior notes			15		500				500
Issuance of restricted stock, net			248	2	14,493			(14,495)	
Amortization of deferred compensation								7,415	7,415
Net earnings							416,543		416,543
Tax benefit related to non-qualified stock options					17,599				17,599
Other comprehensive income, net of tax						65,745			65,745
Dividends declared on common stock, $6.50 per share							(364,482)		(364,482)
Dividends declared on preferred stock,							(5,418)		(5,418)

$1.20 per share									
Balance at December 31. 2005	4,500	45	55,723	557	1,234,362	61,045	828,270	(14,579)	2,109,700
Proceeds from issuance of common stock			547	5	11,411				11,416
Repurchases and cancellation of treasury stock			(552)	(5)	(25,134)				(25,139)
Cancelled shares related to stock options			(88)	(1)	(1,355)				(1,356)
Compensation expense related to common stock options					6,000				6,000
Excess tax benefits related to non-qualified stock options					1,944				1,944
Conversion of convertible senior notes			166	2	4,998				5,000
Restricted stock, net			281	3	(2,271)				(2,268)
Compensation expense related to restricted stock					6,553				6,553
Reclassification of deferred compensation related to adoption of SFAS 123R					(14,579)			14,579	
Net earnings							209,278		209,278
Other comprehensive income, net of tax						21,995			21,995
Dividends declared on common stock, $3.55 per share									