NEW CENTURY FINANCIAL CORP
Form 10-Q
November 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 September 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 October 31, 2006, the registrant had 55,470,607 shares of common stock outstanding.

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2006

INDEX

PART I FINANCIAL INFORMATION

PART II OTHER INFORMATION

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 potential liability the company faces with respect to its legal proceedings; (v) the potential effects of proposed legislation and regulatory actions; (vi) the company s expectation that its adoption of SFAS 155 will not have a material impact on its financial statements; (vii) the company s expectation that its initial adoption of SFAS 156 will not have a material impact to its retained earnings; (viii) the company s expectation that its adoption of FIN 48 will not have a significant impact on its financial statements; (ix) the company s expectation that its initial adoption of SAB 108 will not have a material impact on its financial results; (x) the estimates the company uses to establish its allowance for loan losses; (xi) the estimates the company uses to determine the value of its residual assets including the future rate of prepayments, the prepayment premiums that it expects to receive and the manner in which expected delinquencies, default and default loss severity are expected to affect the amount and timing of the estimated cash flows; (xii) 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; (xiii) the company s estimates with respect to its prepayments and the prepayment characteristics of its mortgage loans; (xiv) the company s expectations with respect to the performance of the mortgage loans held in securitization trusts and the ability of the company to realize the current estimated fair value of its residual assets; (xv) the company s expectations with respect to renewing or extending its various credit facilities; (xvi) the company s expectation that it will reclassify an additional $21.0 million from OCI into earnings during the remainder of 2006 related to expiring contracts; (xvii) the company s expectation that the remaining OCI will be reclassified into earnings by September 2009; (xviii) 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; (xix) the company s estimates with respect to the fair value of its stock options; (xx) 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; (xxi) 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; (xxii) 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; (xxiii) 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; (xxiv) the company s expectation that industry consolidation will continue into 2007; (xxv) the company s belief that its hedging strategies are effective on an economic basis; (xxvi) the company s expectation that the operating environment will continue to be challenging in the fourth quarter of 2006; (xxvii) the company s expectation that loan production volume in the fourth quarter will be moderately lower than the third quarter and the company s non-prime net operating margin will be reduced in the fourth quarter as a result of higher discounted loan sales; (xxviii) the company s expectation that mortgage loan portfolio income in the fourth quarter of 2006 will be lower than the third quarter as the portfolio balance continues to decline; (xxix) the company s strategy for next year focusing on maximizing its core mortgage origination franchise through loan origination process improvement, enhanced productivity and increased efficiencies; (xxx) the company s expectation that it will not add to the mortgage loan portfolio simply to support a dividend target; (xxxi) the company s expectation that it will continue to evaluate whole loan sales versus securitizations on a case-by-case basis based on whole loan prices relative to its view of the risk-adjusted returns on capital available through securitization; (xxxii) the company s belief that the current environment calls for a financial strategy that is flexible enough to capitalize on the opportunities that arise during 2007 giving consideration to secondary and capital market conditions; (xxxiii) the company s belief that it is well-positioned to meet the challenges next year; (xxxiv) the company s expectation that overall mortgage market volume will decline in 2007; (xxxv) the company s belief that its size, scale, financial resources, low loan acquisition costs and reputation will enable it to compete successfully and profitably gain market share in the consolidating mortgage industry; (xxxvi) the company s expectation that, going forward, it will continue to be opportunistic about whole loan sales versus securitization, taking into account secondary market conditions and its capital allocation strategy; (xxxvii) the company s belief that it is adequately reserved for the expected higher level of loan losses after giving consideration to the performance of its newer vintages; (xxxviii) the execution of the company s hedging strategies to mitigate the interest rate risk associated with its loans and reduce the variability in its interest margin over the period of each securitization; (xxxix) the company s belief that the steps it is taking with respect to its underwriting guidelines are prudent in light of the current market environment and will help ensure that specific loan products are appropriate for the circumstances of individual borrowers and will improve the overall credit quality of the company s loans; (xl) the company s plan to continue evaluating its product line; (xli) the company s expectation that its underwriting changes may result in a modest decline in volume, but will not have a meaningful impact to profitability; (xlii) the company s plan to manage the timing of its whole loan sales to enhance the net interest income it earns on its loans, while preserving the company s ability to sell the loans at the maximum price; (xliii) the company s expectation that the volume of discounted sales and the severity of the discount will continue to challenge originators in the Company s industry; (xliv) the company s belief that its ongoing refinement of its underwriting guidelines and continual focus on loan origination process improvement will help mitigate the industry trend relating to higher discounted loan sales; (xlv) 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; (xlvi) the company s design of its underwriting standards, including its recently adopted guidelines for adjustable-rate and interest-only loans, and quality assurance programs to ensure that loan quality is consistent and meets the company s guidelines, even as the mix of documentation type varies; (xlvii) the company s beliefs, estimates and assumptions with respect to its critical accounting policies; (xlviii) 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; (il) the company s use of a prepayment curve to estimate the prepayment characteristics of its mortgage loans; (l) the company s right to terminate, reduce or increase the size of its stock purchase program at any time; (li) the company s execution of its principal strategies to effectively manage its liquidity and capital; (lii) the company s target levels of liquidity and capital; (liii) the company s expectation that prepayment speeds will continue to be at more normal levels through the fourth quarter of 2006; (liv) the company s intention to access the capital markets when appropriate to support its business operations; (lv) the company s intention to execute its stock repurchase program while maintaining its targeted cash and liquidity levels; (lvi) the company s plan to return capital to shareholders through a capital distribution program; (lvii) the company s belief that the cash to fund its stock repurchase and capital distribution program can come from a variety of sources, including, but not limited to, cash flow from its taxable REIT subsidiaries and mortgage banking operations, cash flow from its portfolio of mortgage securities, including the release of over-collateralization from such securities, and through external capital sources; (lviii) 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; (lix) the company s expectation that its fourth quarter dividend will be paid in the amount of $1.90 per share on January 31, 2007 to stockholders of record at the close of business on December 29, 2006; and (lx) 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 its 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
September 30, 2006 and December 31, 2005
(Dollars in thousands)

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 408,860	503,723
Restricted cash	572,847	726,697
Mortgage loans held for sale at lower of cost or market	8,945,134	7,825,175
Mortgage loans held for investment, net of allowance of $191,561 and $198,131, respectively	14,030,999	16,143,865
Residual interests in securitizations held-for-trading	223,680	234,930
Mortgage servicing assets	59,878	69,315
Real estate owned, net of allowance of $56,318 and $18,196, respectively	84,021	37,642
Accrued interest receivable	109,598	101,945
Income taxes, net	80,551	80,823
Office property and equipment, net	87,736	86,886
Goodwill	95,792	92,980
Prepaid expenses and other assets	360,672	243,109
Total assets	$ 25,059,768	26,147,090
LIABILITIES AND STOCKHOLDERS EQUITY		
Credit facilities on mortgage loans held for sale	$ 8,487,850	7,439,685
Financing on mortgage loans held for investment, net	13,858,940	16,045,459
Accounts payable and accrued liabilities	574,258	508,163
Junior subordinated notes	51,545	
Convertible senior notes, net		4,943
Notes payable	22,826	39,140
Total liabilities	22,995,419	24,037,390
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value. Authorized 25,000,000 shares at September 30, 2006 and 10,000,000 shares at December 31, 2005;		
Series A preferred stock; issued and outstanding 4,500,000 shares at September 30, 2006 and December 31, 2005	45	45
Series B preferred stock; issued and outstanding 2,300,000 shares at September 30, 2006 and none at December 31, 2005	23	

Common stock, $0.01 par value. Authorized 300,000,000 shares at September 30, 2006 and December 31, 2005; issued and outstanding 55,329,184 and 55,723,267 shares at September 30, 2006 and December 31, 2005, respectively	553	557
Additional paid-in capital	1,246,451	1,234,362
Accumulated other comprehensive income	23,450	61,045
Retained earnings	793,827	828,270
	2,064,349	2,124,279
Deferred compensation costs		(14,579)
Total stockholders equity	2,064,349	2,109,700
Total liabilities and stockholders equity	$ 25,059,768	26,147,090

See accompanying notes to unaudited condensed consolidated financial statements.

1

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements Of Earnings
(Dollars in thousands, except per share amounts)
(Unaudited)

		Three Months Ended September 30,		Nine Months Ended September 30,	
		2006	**2005**	**2006**	**2005**
Interest income	$	514,172	494,621	1,478,288	1,246,553
Interest expense		(375,228)	(290,899)	(1,019,552)	(671,535)
Net interest income		138,944	203,722	458,736	575,018
Provision for losses on mortgage loans held for investment		(20,756)	(38,542)	(80,906)	(105,655)
Net interest income after provision for losses		118,188	165,180	377,830	469,363
Other operating income:					
Gain on sale of mortgage loans		173,045	176,241	497,732	409,797
Servicing income		17,770	10,203	47,424	23,556
Other income (loss)		(20,747)	4,986	18,845	12,257
Total other operating income		170,068	191,430	564,001	445,610
Operating expenses:					
Personnel		112,575	146,575	356,218	378,258
General and administrative		57,498	49,823	170,086	133,922
Advertising and promotion		14,643	25,661	41,197	66,204
Professional services		13,295	11,580	33,588	29,063
Total operating expenses		198,011	233,639	601,089	607,447
Earnings before income taxes		90,245	122,971	340,742	307,526
Income tax expense		23,603	2,867	64,822	7,583
Net earnings		66,642	120,104	275,920	299,943
Dividends paid on preferred stock		3,174	2,567	8,307	2,852
Net earnings available to common stockholders	$	63,468	117,537	267,613	297,091
Basic earnings per share	$	1.14	2.10	4.81	5.37
Diluted earnings per share	$	1.12	2.04	4.72	5.18
Basic weighted average shares outstanding		55,512,895	55,870,410	55,605,770	55,345,952
Diluted weighted average shares outstanding		56,529,650	57,598,055	56,719,551	57,421,474

See accompanying notes to unaudited condensed consolidated financial statements.

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements Of Comprehensive Income
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Net earnings	$ 66,642	120,104	275,920	299,943
Net unrealized gains (losses) on derivative instruments designated as hedges	(60,792)	66,977	(40,396)	44,371
Reclassification adjustment into earnings for derivative instruments	781	2,375	2,386	9,862
Tax effect	421	(600)	415	(1,449)
Comprehensive income	$ 7,052	188,856	238,325	352,727

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 Nine Months Ended September 30, 2006
(In thousands, except per share amounts)
(Nine Months Ended September 30, 2006 Unaudited)

	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)				