

NEW CENTURY FINANCIAL CORP  
Form 10-Q  
May 15, 2003

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

## FORM 10-Q

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

For the quarterly period ended March 31, 2003

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 000-22633

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# NEW CENTURY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

**DELAWARE**

**33-0683629**

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(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

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**18400 VON KARMAN, SUITE 1000, IRVINE, CALIFORNIA 92612**

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code:

**(949) 440-7030**

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**Not Applicable**

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

Indicate by check  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 twelve 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  whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

**As of April 30, 2003, the registrant had 23,905,672 shares of common stock outstanding.**

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

FORM 10-Q

QUARTER ENDED MARCH 31, 2003

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Certain information included in this Form 10-Q may include forward-looking statements under federal securities laws, and we intend that such forward-looking statements be subject to the safe-harbor created thereby. Such statements include, without limitation, (i) our beliefs regarding our critical accounting policies, (ii) the assumptions underlying our hedging strategy, (iii) our plan to mitigate interest rate risk in our residual assets, (iv) our plan to continue to fund repurchases pursuant to our stock repurchase program with available corporate liquidity, (v) our expectation that the number of shares to be purchased pursuant to our stock repurchase plan and the time of the purchases will be based upon the level of cash balances, general business conditions and other factors, including alternative investment opportunities, (vi) our plan to continue to concentrate on generating positive cash flow from operations, (vii) our plan to continue to maintain low loan acquisition costs, (viii) our plan to manage the number of loans that we must sell at a discount as a result of defects because they are rejected by loan buyers or because the borrower failed to make the first payment, (ix) our plan to reduce the size of the average loss on sale for those loans that are sold at a discount, (x) our plan to improve the gain on sale of loans sold at a premium, (xi) our plan to optimize net interest income by holding loans for a longer period of time prior to their sale or securitization, (xii) our plan to employ on-balance sheet securitizations to generate cash flows from net interest spread income, (xiii) our plan to seek a facility to finance servicing-related advance obligations, (xiv) our expectation that our liquidity, credit facilities and capital resources will be sufficient to fund our operations for the foreseeable future, (xv) our expectation that our servicing operations will continue to grow and to contribute an increasing amount to our revenues and earnings in future periods, and (xvi) our belief that any liability with respect to our legal proceedings arising out of the ordinary course of our business will not have a material adverse effect on our business, results of operation or financial position.

We caution that these statements are qualified by important factors that could cause our 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 condition of the markets for whole loans and mortgage-backed securities, (iii) the stability of residential property values, (iv) our ability to continue to maintain low loan acquisition costs, (v) the potential effect of new state or federal laws and regulations, (vi) the effect of increasing competition in our sector, (vii) our ability to maintain adequate credit facilities to finance our business, (viii) the interest rate environment, (ix) our ability to adequately hedge our residual values, (x) the ability of our servicing platform to maintain high performance standards, and (xi) the initiation of a margin call under any of our warehouse or aggregation facilities. Additional information on these and other factors is contained in our Annual Report on Form 10-K for the year ended December 31, 2002 and our other periodic filings with the Securities and Exchange Commission. We assume no obligation to update the forward-looking statements contained in this Form 10-Q.

## New Century Financial Corporation and Subsidiaries

## Condensed Consolidated Balance Sheets

(Dollars in thousands, except share data)

(Unaudited)

	March 31, 2003	December 31, 2002
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 57,716	\$ 182,924
Loans receivable held for sale, net (notes 2 and 5)	1,943,236	1,920,396
Securitized mortgage loans held for investment, net (note 3)	491,174	
Residual interests in securitizations (note 4)	223,180	246,964
Mortgage servicing assets (note 5)	10,175	10,271
Office property and equipment	21,180	20,336
Prepaid expenses and other assets (note 6)	30,928	22,037
	<u>2,777,589</u>	<u>2,402,928</u>
<b>TOTAL ASSETS</b>	<b>\$ 2,777,589</b>	<b>\$ 2,402,928</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
Warehouse and aggregation lines of credit (note 7)	\$ 1,748,538	\$ 1,885,498
Financing on securitized mortgage loans (note 8)	475,867	
Notes payable	14,568	16,699
Income taxes payable	35,810	24,611
Accounts payable and accrued liabilities	80,984	83,890
Deferred income taxes	5,680	5,680
	<u>2,361,447</u>	<u>2,016,378</u>
<b>Total liabilities</b>	<b>2,361,447</b>	<b>2,016,378</b>
<b>Stockholders' equity:</b>		
Preferred stock, \$0.01 par value. Authorized 7,500,000 shares; zero shares outstanding at March 31, 2003 and December 31, 2002		
Common stock, \$0.01 par value. Authorized 45,000,000 shares; issued and outstanding 23,834,134 shares at March 31, 2003 and 23,538,470 shares at December 31, 2002	238	235
Additional paid-in capital	121,894	115,345
Retained earnings, restricted	322,563	279,124
	<u>444,695</u>	<u>394,704</u>
Treasury stock, 769,500 shares at March 31, 2003 and 184,000 shares at December 31, 2002, respectively, at cost	(20,678)	(4,439)
Deferred compensation costs	(7,875)	(3,715)
	<u>416,142</u>	<u>386,550</u>
<b>Total stockholders' equity</b>	<b>416,142</b>	<b>386,550</b>
	<u>2,777,589</u>	<u>2,402,928</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 2,777,589</b>	<b>\$ 2,402,928</b>

See accompanying notes to unaudited condensed consolidated financial statements.



## New Century Financial Corporation and Subsidiaries

## Condensed Consolidated Statements of Operations

(Dollars in thousands, except per share amounts)

(Unaudited)

	Three Months Ended	
	March 31,	
	2003	2002
<b>Revenues:</b>		
Gain on sale of loans	\$ 125,802	\$ 78,433
Interest income (note 3)	46,148	25,977
Residual interest income (note 4)	6,565	7,840
Servicing income	2,473	41
Other income		7
<b>Total revenues</b>	<b>180,988</b>	<b>112,298</b>
<b>Expenses:</b>		
Personnel	49,179	29,358
Interest	17,552	11,270
General and administrative	27,264	13,761
Advertising and promotion	6,187	3,087
Professional services	2,749	1,559
<b>Total expenses</b>	<b>102,931</b>	<b>59,035</b>
<b>Earnings before income taxes</b>	<b>78,057</b>	<b>53,263</b>
Income taxes	32,318	22,345
<b>Net earnings</b>	<b>\$ 45,739</b>	<b>\$ 30,918</b>
Dividends on preferred stock		(442)
<b>Net earnings available to common stockholders</b>	<b>\$ 45,739</b>	<b>\$ 30,476</b>
<b>Basic earnings per share (note 9)</b>	<b>\$ 2.00</b>	<b>\$ 1.49</b>
<b>Diluted earnings per share (note 9)</b>	<b>\$ 1.84</b>	<b>\$ 1.21</b>

See accompanying notes to unaudited condensed consolidated financial statements.

## New Century Financial Corporation and Subsidiaries

## Condensed Consolidated Statements of Cash Flows

Three Months Ended March 31, 2003 and 2002

(In thousands)

	<u>March 31,</u> <u>2003</u>	<u>March 31,</u> <u>2002</u>
Cash flows from operating activities:		
Net earnings	\$ 45,739	\$ 30,918
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,930	2,005
NIR gains		12,050
Initial deposits to OC accounts		(17,878)
Cash flows received from residual interests	31,955	13,715
Accretion of NIRs	(6,565)	(8,602)
Servicing gains	(7,777)	(4,611)
Fair value adjustment of residual securities	(1,606)	3,889
Provision for losses	4,361	20,604
Loans originated or acquired for sale	(4,201,354)	(2,657,001)
Loan sales, net	4,155,224	2,516,764
Principal payments on loans receivable held for sale and investment	19,606	4,971
Increase (decrease) in warehouse and aggregation lines of credit	(136,960)	112,254
Net change in other assets and liabilities	3,073	15,579
	<u>(90,374)</u>	<u>44,657</u>
Cash flows from investing activities:		
Loans originated or acquired for investment	(491,076)	
Purchase of office property and equipment	(3,965)	(2,114)
Sale of mortgage servicing rights	7,791	
	<u>(487,250)</u>	<u>(2,114)</u>
Cash flows from financing activities:		
Net repayments of residual financing		(21,814)
Proceeds from issuance of securitization financing, net	471,421	
Proceeds from (net repayments of) notes payable	(2,131)	(1,181)
Payment of dividends on convertible preferred stock		(725)
Payment of dividends on common stock	(2,300)	(1,028)
Net proceeds from issuance of stock	2,240	3,612
Purchase of treasury stock	(16,814)	(7,847)
	<u>452,416</u>	<u>(28,983)</u>
Net increase (decrease) in cash and cash equivalents	(125,208)	13,560
Cash and cash equivalents, beginning of period	182,924	106,679
	<u>\$ 57,716</u>	<u>\$ 120,239</u>



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Supplemental cash flow disclosure:		
Interest paid	\$ 18,229	\$ 10,981
Income taxes paid	\$ 21,119	\$ 3,261
Supplemental non-cash financing activity:		
Restricted stock issued	\$ 4,887	\$ 291
Restricted stock cancelled	\$	\$ 210
Accrued dividends	\$ 2,339	\$ 1,241

See accompanying notes to unaudited condensed consolidated financial statements.

**NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**March 31, 2003 and 2002**

1. Basis of Presentation

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

*Recent Accounting Developments*

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45, which clarifies previously issued accounting guidance and disclosure requirements for guarantees, expands the disclosures to be made by a guarantor in its financial statements about its obligations under certain guarantees, and requires the guarantor to recognize a liability for the fair value of an obligation assumed under a guarantee.

In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on specified changes in an underlying variable that is related to an asset, liability, or equity security of the guaranteed party. Guarantee contracts excluded from both the disclosure and recognition requirements of FIN 45 include, among others, guarantees relating to employee compensation, residual value guarantees under capital lease arrangements, commercial letters of credit, commitments to extend credit, subordinated interests in a special purpose entity, and guarantees of a company's own future performance. Other guarantees subject to the disclosure requirements of FIN 45, but not to the recognition provisions, include, among others, a guarantee accounted for as a derivative instrument under SFAS No. 133, a parent's guarantee of debt owed to a third party by its subsidiary or vice versa, and a guarantee which is based on performance but not price. We adopted the disclosure provisions of FIN 45 and have included all appropriate and necessary disclosures in our financial statements and footnotes. The adoption of FIN 45 did not have a material impact on our consolidated financial position, results of operations, or liquidity.

In January 2003, the FASB issued Interpretation 46, Consolidation of Variable Interest Entities an interpretation of ARB No. 51 ( FIN 46 ), which requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns or both. Prior to FIN 46, a company included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46 also requires disclosures about variable interest entities that the company is not required to consolidate but in which it has a significant variable interest. The consolidated requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidated requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain disclosure requirements of FIN 46 apply to all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. At present, our variable interest entities are special purpose entities, which are outside the scope of FIN 46.

#### *Residual Interests in Securitizations*

Residual interests in securitizations are recorded as a result of the sale of loans through securitizations and the sale of residual interests in securitizations through what are sometimes referred to as net interest margin securities, or NIMS.

We generally structure the loan securitizations as follows: First, we sell a portfolio of mortgage loans to a special purpose entity, or SPE, that we have established for the limited purpose of buying and reselling mortgage loans. The SPE then transfers the same mortgage loans to a Real Estate Mortgage Investment Conduit or Owners Trust (the REMIC or Trust ), and the Trust in turn issues interest-bearing asset-backed securities (the Certificates ) generally in an amount equal to the aggregate principal balance of the mortgage loans. The Certificates are typically sold at face value and without recourse except that we provide representations and warranties customary to the mortgage banking industry to the Trust. One or more investors purchase these Certificates for cash. The Trust uses the cash proceeds to pay us the cash portion of the purchase price for the mortgage loans. The Trust also issues a certificate to us representing a residual interest in the payments on the securitized loans. In addition, we may provide a credit enhancement for the benefit of the investors in the form of additional collateral

( Over-collateralization Account or OC Account ) held by the Trust. The servicing agreement requires that the OC Account be maintained at certain levels.

At the closing of each securitization structured as a sale, we remove from our consolidated balance sheet the mortgage loans held for sale and add to our consolidated balance sheet (i) the cash received, (ii) the estimated fair value of the interest in the mortgage loans retained from the securitizations ( Residuals ), which consist of (a) the OC Account and (b) the net interest receivable ( NIR ), and (iii) the estimated fair value of the servicing asset. The NIR represents the discounted estimated cash flows that we will receive in the future. The excess of the cash received and the assets retained over the carrying value of the loans sold, less transaction costs, equals the net gain on sale of mortgage loans recorded by us.

The NIMS are generally structured as follows: First, we sell or contribute the Residuals to a SPE that we have established for the limited purpose of receiving and selling asset-backed residual interests in securitization certificates. Next, the SPE transfers the Residuals to the Trust and the Trust, in turn, issues interest-bearing asset-backed securities (the Bonds and Certificates ). We sell the Residuals without recourse except that we provide representations and warranties customary to the mortgage banking industry to the Trust. One or more investors purchase the Bonds and Certificates and the proceeds from the sale of the Bonds and Certificates, along with a residual interest certificate that is subordinate to the Bonds and Certificates, represents our consideration for the sale of the Residuals.

At closing of each NIMS transaction, we remove from our consolidated balance sheet the carrying value of the Residuals sold and add to our consolidated balance sheet (i) the cash received, and (ii) the estimated fair value of the portion of the Residuals retained, which consists of a NIR. The excess of the cash received and assets retained over the carrying value of the Residuals sold, less transaction costs, equals the net gain or loss on the sale of Residuals recorded by us.

We allocate our basis in the mortgage loans and Residuals between the portion of the mortgage loans and Residuals sold through the Certificates and the portion retained (the Residuals and servicing assets) based on the relative fair values of those portions on the date of sale. We may recognize gains or losses attributable to the changes in the fair value of the Residuals, which are recorded at estimated fair value and accounted for as held-for-trading securities. We are not aware of an active market for the purchase or sale of Residuals and, accordingly, we determine the estimated fair value of the Residuals by discounting the expected cash flows released from the OC Account (the cash out method) using a discount rate commensurate with the risks involved. We utilize a discount rate of 12.0% on the estimated cash flows released from the OC Account to value the Residuals through securitization transactions and 14.0% on the estimated cash flows released from the Trust to value Residuals through NIMS transactions.

We are entitled to the cash flows from the Residuals that represent collections on the mortgage loans in excess of the amounts required to pay the Certificates principal and interest, the servicing fees and certain other fees, such as trustee and custodial fees. At the end of each collection period, the aggregate cash collections from the mortgage loans are allocated first to the base servicing fees and certain other fees, such as trustee and custodial fees, for the period, then to the Certificate holders for interest at the pass-through

rate on the Certificates plus principal as defined in the servicing agreements. If the amount of cash required for the above allocations exceeds the amount collected during the collection period, the shortfall is drawn from the OC Account. If the cash collected during the period exceeds the amount necessary for the above allocation, and there is no shortfall in the related OC Account, the excess is released to us. If the OC Account balance is not at the required credit enhancement level, the excess cash collected is retained in the OC Account until the specified level is achieved. We are restricted from using the cash and collateral in the OC Account. Pursuant to certain servicing agreements, we may use cash held in the OC Account to make accelerated principal paydowns on the Certificates to create additional excess collateral in the OC Account which is held by the Trusts on our behalf as the Residual holder. The specified credit enhancement levels are defined in the servicing agreements as the OC Account balance expressed generally as a percentage of the current collateral principal balance.

For NIMS transactions, we receive cash flows once the holders of the Bonds and Certificates created in the NIMS transaction are fully paid. The Annual Percentage Rate, or APR, on the mortgage loans is relatively high in comparison to the pass-through rate on the Certificates. Accordingly, the Residuals described above are a significant asset of New Century. In determining the value of the Residuals, we must estimate the future rates of prepayments, prepayment penalties that we will receive, delinquencies, defaults and default loss severity as they affect the amount and timing of the estimated cash flows. We estimate average cumulative losses as a percentage of the original principal balance of the mortgage loans of 1.44% to 3.94% for adjustable-rate securities and 2.16% to 4.75% for fixed-rate securities. These estimates are based on historical loss data for our loans, the specific characteristics of the loans, and the existence of mortgage insurance. While the range of estimated cumulative pool losses is fairly broad, the weighted average cumulative pool loss estimate for the entire portfolio of residual assets was 3.88% at March 31, 2003. We estimate prepayments by evaluating historical prepayment performance of our loans and the impact of current trends. We use a prepayment curve to estimate the prepayment characteristics of the mortgage loans. The rate of increase, duration, severity, and decrease of the curve depends on the age and nature of the mortgage loans, primarily whether the mortgage loans are fixed or adjustable and the interest rate adjustment characteristics of the mortgage loans (6-month, 1-year, 2-year, 3-year, or 5-year adjustment periods). Our prepayment curve and default estimates have resulted in weighted average lives of between 2.42 to 3.03 years for our adjustable-rate securities and 2.63 to 3.78 years for our fixed-rate securities.

Historically, we have performed an evaluation of our Residuals quarterly, which takes into consideration trends in actual cash flow performance, industry and economic developments, as well as other relevant factors.

Our Residuals performed as projected during the first quarter of 2003 and provided \$32.0 million in cash flow. As of March 31, 2003, we updated the model to the current forward LIBOR curve, resulting in a \$3.8 million increase in value. We also modeled certain securitizations to fail step-up triggers, thus delaying cash flows to us, resulting in a \$2.2 million decrease in value. The net effect of these changes was a net write-up in value of \$1.6 million.

The Bond and Certificate holders and their securitization trusts have no recourse to New Century for failure of mortgage loan borrowers to pay when due. Our Residuals are subordinate to the Bonds and Certificates until the Bond and Certificate holders are fully paid.

*On-Balance Sheet Securitization*

We structured the current quarter securitization as a financing transaction, and accordingly hold the mortgage loans for investment on our balance sheet. The mortgage loans remain on our balance sheet and the securitization bond financing effectively finances the securitized mortgage loans. We record interest income on the mortgage loans and interest expense on the bond financing issued over the life of the loans instead of recognizing a one-time gain or loss upon completion of the securitization.

*Stock-Based Compensation*

We have elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ), and related interpretations, in accounting for employee stock options rather than the alternative fair value accounting allowed by FASB Statement No. 123,

*Accounting for Stock-Based Compensation* ( SFAS 123 ). APB 25 provides that compensation expense relative to our employee stock options is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. Under SFAS 123, the fair value of stock options at the date of grant is recognized in earnings over the vesting period of the options. In December 2002, FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* ( SFAS 148 ), which amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method on reported results.

As of March 31, 2003 and 2002, there were stock options outstanding for the purchase of 3,456,661 and 2,618,061 shares, respectively, of our common stock. The fair value of the stock options granted during the quarters ended March 31, 2003 and 2002 was \$10.27 and \$5.98, respectively. The following table shows the pro forma net income as if the fair value method of SFAS No. 123 had been used to account for stock-based compensation expense (dollars in thousands, except per share amounts):

	<b>For the Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2003</b>	<b>2002</b>
Net income, as reported	\$ 45,739	\$ 30,476
Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	894	487
<b>Pro forma net income</b>	<b>\$ 44,845</b>	<b>\$ 29,989</b>
<b>Net income per share:</b>		
Basic, as reported	\$ 2.00	\$ 1.49
Diluted, as reported	\$ 1.84	\$ 1.21
Pro forma, basic	\$ 1.96	\$ 1.47

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Pro forma, diluted	\$	1.81	\$	1.19
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2. Loans Receivable Held for Sale

A summary of loans receivable held for sale, at the lower of cost or market at March 31, 2003 and December 31, 2002 follows (dollars in thousands):

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
Mortgage loans receivable	\$ 1,937,836	\$ 1,918,196
Net deferred origination costs	5,400	2,200
	<u>\$ 1,943,236</u>	<u>\$ 1,920,396</u>

3. Securitized Mortgage Loans Held for Investment

During the first quarter of 2003, we sold loans through a securitization structured as an on-balance sheet securitization. The components of securitized mortgage loans held for investment at March 31, 2003 are as follows (dollars in thousands):

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
Mortgage loan principal balances	\$ 489,903	
Allowance for loan losses	(3,182)	
Net deferred origination costs	4,453	
	<u>\$ 491,174</u>	<u>\$</u>

(a) Interest Income

The following table presents the components of interest income for the three months ended March 31, 2003 and December 31, 2002 (dollars in thousands):

	<u>2003</u>	<u>2002</u>
Interest on loans receivable held for sale	\$ 39,872	25,929
Interest on loans held for investment	6,264	
Interest on cash and cash equivalents	12	48



	<u>          </u>	<u>          </u>
	\$ 46,148	25,977
	<u>          </u>	<u>          </u>

4. Residual Interests in Securitizations

Residual interests in securitizations consist of the following components at March 31, 2003 and December 31, 2002 (dollars in thousands):

	<b>March 31, 2003</b>	<b>December 31, 2002</b>
Over-collateralization account	\$ 174,948	\$ 185,658
Net interest receivable (NIR)	48,232	61,306
	<b>\$ 223,180</b>	<b>\$ 246,964</b>

The following table summarizes activity in the NIR accounts for the three months ended March 31, 2003 and 2002 (dollars in thousands):

	<b>March 31, 2003</b>	<b>March 31, 2002</b>
Balance, beginning of period	\$ 61,306	\$ 99,973
NIR premiums (discounts)		(12,050)
Cash received from NIRs	(21,245)	(19,001)
Accretion of NIR	6,565	8,602
Fair value adjustment	1,606	(3,889)
Balance, end of period	<b>\$ 48,232</b>	<b>\$ 73,635</b>

The following table summarizes activity in the OC Accounts for the three months ended March 31, 2003 and 2002 (dollars in thousands):

	<b>March 31, 2003</b>	<b>March 31, 2002</b>
Balance, beginning of period	\$ 185,658	\$ 206,935
Initial deposits to OC Accounts		17,878
Additional deposits to OC Accounts	4,140	7,474
Release of cash from OC Accounts	(14,850)	(2,188)
Balance, end of period	<b>\$ 174,948</b>	<b>\$ 230,099</b>

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5. Mortgage Servicing Assets

Mortgage servicing assets represent the carrying value of our mortgage loan servicing rights. The following table summarizes activity in mortgage servicing assets for the three months ended March 31, 2003 and 2002 (dollars in thousands):

	March 31, 2003	March 31, 2002
	<u>2003</u>	<u>2002</u>
Balance, beginning of period	\$ 10,271	\$
Additions	7,777	4,611
Sales of servicing rights	(7,791)	
Amortization	(82)	(50)
	<u>          </u>	<u>          </u>
Balance, end of period	<u>\$ 10,175</u>	<u>\$ 4,561</u>

We record mortgage servicing assets when we sell loans on a servicing retained basis in connection with our plan to grow our servicing portfolio, and when we sell loans through whole loan sales to an investor in the current period and sell the servicing rights to a third party in a subsequent period.

Additions of \$7.8 million and \$4.6 million during the first quarters of 2003 and 2002, respectively, represent the value of servicing rights held temporarily for loans sold in those periods, pending the sale of those servicing rights to third parties in subsequent periods. We did not sell loans on a servicing-retained basis in the first quarter of 2003 or 2002, other than the securitization structured as a financing in 2003.

In accordance with generally accepted accounting principles, we do not record mortgage servicing assets for loans sold through securitizations that are structured as financings.

6. Goodwill

Goodwill is recorded in connection with the acquisition of new subsidiaries and is included in prepaid expenses and other assets. As of March 31, 2003, we had goodwill of \$13.7 million. No impairment existed at March 31, 2003 or March 31, 2002.

7. Warehouse and Aggregation Lines of Credit

Warehouse and aggregation lines of credit consist of the following at March 31, 2003 and December 31, 2002 (dollars in thousands):

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
A \$470 million line of credit from CDC Mortgage Capital expiring in March 2004, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	\$ 379,197	\$ 420,317
A \$900 million loan and security agreement from Morgan Stanley Dean Witter Mortgage Capital expiring in December 2003, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	43,637	149,143
A \$50 million master loan and security agreement from Salomon Brothers Realty expiring in December 2003, secured by delinquent loans and REO properties, bearing interest based on a margin over one-month LIBOR	9,773	6,718
A \$650 million aggregation facility from Salomon Brothers Realty expiring in December 2003, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	319,859	81,501
A \$750 million line of credit from Bank of America, N.A. expiring in May 2004, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	311,092	312,754
A \$750 million line of credit from UBS Warburg Real Estate Securities expiring in May 2004, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	684,980	418,577
A \$150 million line of credit from Salomon Brothers Realty expiring in December 2003, secured by loans receivable held for sale, bearing interest based on a margin over one-month LIBOR	—	—
Loan sale agreement accounted for as a financing:		
Federal Home Loan Mortgage Corporation sale of 77.5% participation certificates that expired in January 2003, secured by mortgage loans to be securitized, bearing interest based on a margin over one-month LIBOR	—	384,778
A \$111.7 short-term million Loan and Security Agreement from Morgan Stanley Dean Witter Mortgage Capital that expired in February 2003, secured by mortgage loans to be securitized, bearing interest based on a margin over one-month LIBOR	—	111,710
	<u>\$ 1,748,538</u>	<u>\$ 1,885,498</u>

The warehouse and aggregation line of credit agreements contain certain restrictive financial and other covenants, which require us to, among other things, restrict dividends, maintain certain net worth and liquidity levels, remain below specified debt-to-net-worth ratios and comply with regulatory and investor requirements. At March 31, 2003, we were in compliance with all material financial and other covenants in our warehouse and aggregation facilities.

#### 8. Financing on Securitized Mortgage Loans

On January 24, 2003, New Century Home Equity Loan Trust, Series 2003-1 (the Trust) issued \$483.7 million of Asset-Backed Pass-Through Certificates (the Certificates) secured by a pool of one- to four-family residential first lien mortgage loans (the Mortgage Loans) in a public offering. The Mortgage Loans were sold by NC Capital Corporation to New Century Mortgage Securities, Inc., a special purpose entity (the Depositor), pursuant to a Mortgage Loan Purchase Agreement, dated January 23, 2003, and the Depositor sold the Mortgage Loans to the Trust pursuant to a Pooling and Servicing Agreement, dated as of January 1, 2003, among the Depositor, New Century Mortgage Corporation, as master servicer, and Deutsche Bank National Trust Company, as trustee. The Certificates issued pursuant to the Pooling and Servicing Agreement were issued by the Depositor to Salomon Smith Barney Inc. pursuant to an Underwriting Agreement, dated January 23, 2003, and the cash consideration from the sale of the Certificates was remitted to NC Capital Corporation in exchange for the Mortgage Loans. Each class of Certificates accrues interest at a pass-through rate equal to one-month LIBOR plus an applicable margin.

The Mortgage Loans are legally owned by the Trust and are not available to the creditors of the Depositor or its affiliates. As such, the Bond and Certificate holders and their securitization trust have no recourse to New Century for the failure of mortgage loan borrowers to pay when due. Our remaining interests in the assets in the Trust are subordinate to the Bonds and the Certificates until the Bond and Certificate holders are fully paid.

#### 9. Earnings per Share

The following table illustrates the computation of basic and diluted earnings per share for the periods indicated (dollars in thousands, except per share amounts):