HOUSTON AMERICAN ENERGY CORP
Form 10QSB/A
November 28, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB/A
Amendment No. 2

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

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 0-33027

HOUSTON AMERICAN ENERGY CORP
(Exact name of small business issuer as specified in its charter)

Delaware	76-0675953
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

801 Travis Street, Suite 2020, Houston, Texas 77002
(Address of principal executive offices)(Zip Code)

(713) 222-6966
(Registrant's telephone number, including area code)

(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 such filing requirements for the past 90 days. Yes [X] No [ ]

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

As of November 8, 2005, we had 19,968,089 shares of $0.001 par value Common Stock outstanding.

Transitional Small Business Disclosure Format (check one) Yes [ ] No [X]

EXPLANATORY NOTE

This quarterly report on Form 10-QSB/A ("Form 10-QSB/A"), Amendment No. 2, is being filed to amend our quarterly report on Form 10-QSB for the quarter ended September 30, 2005 (the "Original Form 10-QSB"), which was originally filed with the Securities and Exchange Commission ("SEC") on November 14, 2005 and amended on November 13, 2006.

This form 10-QSB/A amends Part I, Item 3 to delete an improper reference to a conclusion that the company failed to properly account for certain stock option grants.

Pursuant to rule 12b-15 under the Securities Exchange Act of 1934, the Form 10-QSB/A contains complete text of Items 1, 2 and 3 of Part I and Items 1 and 6 of Part II, as amended, as well as currently dated certifications from the Principal Executive Officer and the Principal Financial Officer.

This Form 10-QSB/A does not reflect events occurring after the filing of the Original Form 10-QSB and does not modify or update the disclosure therein in any way other than as required to reflect the amendments discussed above.

HOUSTON AMERICAN ENERGY CORP.

FORM 10-QSB/A

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

HOUSTON AMERICAN ENERGY CORP.
BALANCE SHEET
September 30, 2005
(Unaudited)
(Restated)

ASSETS

CURRENT ASSETS:	
Cash	$ 1,790,184
Accounts receivable	473,649
Prepaid expenses	1,396
Total current assets	2,265,229
PROPERTY, PLANT AND EQUIPMENT	
Oil and gas properties - full cost method	
Costs subject to amortization	3,045,335
Costs not being amortized	714,283
Furniture and equipment	10,878
Total property, plant and equipment	3,770,496
Accumulated depreciation and depletion	(1,232,747)
Total property, plant and equipment, net	2,537,749
OTHER ASSETS	120,236
Total Assets	$ 4,923,214

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:	
Accounts payable	$ 278,668
Accrued expenses	79,953
Derivative liability	2,761,791
Total current liabilities	3,120,412
LONG-TERM DEBT:	
Notes payable to principal shareholder	1,000,000
Subordinated convertible notes - net of discount	19,206
Reserve for plugging costs	44,456
Total long-term liabilities	1,063,662
SHAREHOLDERS' EQUITY:	
Common stock, $0.001 par value; 100,000,000 shares authorized; 19,968,089 shares outstanding	19,968
Additional paid-in capital	2,800,027
Treasury stock, at cost; 100,000 shares	(85,834)

Accumulated deficit	(1,995,021)
Total shareholders' equity	739,140
Total liabilities and shareholders' equity	$ 4,923,214

The accompanying notes are an integral part of these financial statements

HOUSTON AMERICAN ENERGY CORP.
STATEMENT OF OPERATIONS
(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2005	2004	2005	2004
	(Restated)		(Restated)	
Revenue:				
Oil and gas	$ 1,824,582	$ 672,822	$ 732,642	$ 369,274
Consulting fees	25,000	-	25,000	-
Total revenue	1,849,582	672,822	757,642	369,274
Expenses of operations:				
Lease operating expense and severance tax	710,702	283,322	239,727	163,824
Joint venture expenses	43,105	25,637	15,681	19,589
General and administrative expense	542,590	202,906	200,837	75,627
Depreciation and depletion	223,392	88,918	53,034	31,425
Total operating expenses	1,519,789	600,783	509,279	290,465
Income from operations	329,793	72,039	248,363	78,809
Other (income) expenses:				
Interest income	(21,084)	(4,995)	(13,314)	(692)
Interest expense	69,420	-	42,500	22,400
Interest expense - derivative	304,753	-	12,317	-
Interest expense - shareholders	54,000	54,000	18,000	-
Financing costs	10,431	-	6,386	-
Net change in fair value of derivative liabilities	351,244	-	289,214	-
Total other (income) expenses, net	768,764	49,005	355,103	21,708
Net income (loss)	$ (438,971)	$ 23,034	$ (106,740)	$ 57,101

Basic income per share	$ (0.02)	$ 0.00	$ (0.01)	$ 0.00
Diluted income per share	$ (0.02)	$ 0.00	$ (0.01)	$ 0.00
Basic weighted average shares	19,968,089	19,578,703	19,968,089	19,663,081
Diluted weighted average shares	19,968,089	19,578,703	19,968,089	19,663,081

HOUSTON AMERICAN ENERGY CORP.
STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Nine Months Ended September 30,	
	2005	2004
	(Restated)	
CASH FLOWS FROM OPERATING ACTIVITIES		
(Loss) Income from operations	$ (438,971)	$ 23,034
Adjustments to reconcile net income to net cash from operations		
Depreciation and depletion	223,392	88,918
Non-cash expenses	-	19,416
Change in fair value of derivatives	351,244	-
Amorization of debt discount	304,753	-
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(233,508)	(148,937)
(Increase) decrease in prepaid expense	88,551	(25,987)
(Increase) decrease in other assets	(117,069)	36,863
Increase in accounts payable and accrued expenses	118,264	140,176
Net cash provided by operations	296,656	133,483
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of oil and gas properties and assets	(1,353,085)	(589,163)
Funds received in excess of prospect costs	-	21,650
Net cash used by investing activities	(1,353,085)	(567,513)
CASH FLOWS FROM FINANCING ACTIVITIES		
Sale of common stock - net of costs	-	91,193
Issuance of debt	2,125,000	-
Net cash provided by financing activities	2,125,000	91,193

Increase (decrease) in cash and equivalents	1,068,571	(342,837)
Cash, beginning of period	721,613	663,422
Cash, end of period	$ 1,790,184	$ 320,585
SUPPLEMENT CASH FLOW INFORMATION:		
Interest paid	$ 54,000	$ 36,000
SUPPLEMENT NON-CASH INVESTING AND FINANCING ACTIVITIES		
Stock issued for oil and gas activity	$ -	$ 47,500
Stock issued for financial public relations	-	103,000
Warrants issued for financing fees	162,562	-

HOUSTON AMERICAN ENERGY CORP.
Notes to Financial Statements
September 30, 2005
(Unaudited)

NOTE 1. - BASIS OF PRESENTATION

The accompanying unaudited financial statements of Houston American Energy Corp., a Delaware corporation (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Item 310(b) of Regulation S-B. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for a complete financial presentation. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included in the accompanying unaudited financial statements. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the financial statements and footnotes, which are included as part of the Company's Form 10-KSB for the year ended December 31, 2004.

NOTE 2. - CHANGES IN PRESENTATION

Certain financial presentations for the periods presented for 2004 have been reclassified to conform to the 2005 presentation.

NOTE 3. - RESTATED FINANCIAL STATEMENTS

The accompanying financial statements as of September 30, 2005 and for the three-month and nine-month periods ended September 30, 2005 are restated from those originally issued to reflect certain adjustments related to derivative financial instruments.

The restatement relates to the accounting for embedded features in certain convertible notes and warrants issued by the Company during 2005 (See Note 4 below). The notes were originally recorded at their notional amounts; and the fair value of the warrants was included in Shareholders' Equity. The Company subsequently determined that the convertible notes and warrants contain detachable and embedded derivatives that should have been accounted for as

derivative financial instruments in accordance with SFAS 133 and EITF 00-19 (See Note 5 below).

In connection with the referenced restatement, interest income and certain financing costs have been reclassified from operating revenue and expense, respectively, to other (income) expense.

The following is a summary of the restatement adjustments.

	As Previously Reported	Adjustments	As Restat
Balance Sheet			
Other assets	269,499	(149,263)	120,2
Total Assets	5,072,477	(149,263)	4,923,2
Currently liabilities			
Derivative liability	-	2,761,791	2,761,7
Total Current Liabilities	358,621	2,761,791	3,120,4
Long term debt			
Subordinated convertible notes	2,125,000	(2,105,794)	19,2
Total long term debt	3,169,456	(2,105,794)	1,063,6
Shareholder Equity			
Additional paid in capital	2,962,589	(162,562)	2,800,0
Accumulated deficit	(1,352,323)	(642,698)	(1,995,0
Total Stockholders' Equity	1,544,400	(805,260)	739,1
Total Liabilities and Shareholders' Equity	5,072,477	(149,263)	4,923,2
Statement of Operations Nine Months Ended 9/30/05			
Other (Income) Expense			
Interest expense-derivative	-	304,753	304,7
Net change in fair value of derivative liabilities	-	351,244	351,2
Financing costs	23,730	(13,299)	10,4
Total Other (Income) Expense	126,066	642,698	768,7
Net Income (Loss)	203,727	(642,698)	(438,9
Basic income (loss) per share	$ 0.01	$ (0.03)	$ (0.
Diluted income (loss) per share	$ 0.01	$ (0.03)	$ (0.
Three Months Ended 9/30/05			
Other (Income) Expense			
Interest expense-derivative	-	12,317	12,3
Net change in fair value of derivative liabilities	-	289,214	289,2
Financing costs	14,529	(8,143)	6,3
Interest expense			
Total Other (Income) Expense	61,715	293,388	355,1

Net Income (Loss)	186,647	(293,388)	(106,7
Basic and diluted income (loss) per share	$ 0.01	$ (0.02)	$ (0.

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NOTE 4. - SUBORDINATED CONVERTIBLE NOTES AND WARRANTS

On May 4, 2005, the Company entered into Purchase Agreements (the "Purchase Agreements") with multiple investors pursuant to which the Company sold $2,125,000 of 8% Subordinated Convertible Notes Due 2010 (the "Notes").

The Notes bear interest at 8%, provide for semi-annual interest payments and mature May 1, 2010. The Notes are convertible, at the option of the holders, into common stock of the Company at a price of $1.00 per share (the "Conversion Price"), subject to standard anti-dilution provisions relating to splits, reverse splits and other transactions, including issuances of common stock at prices below the Conversion Price. The Notes are subject to automatic conversion in the event the Company conducts an underwritten public offering of its common stock from which the Company receives at least $5 million and the public offering price is at least 150% of the then applicable Conversion Price. The Company has the right to cause the Notes to be converted into common stock after May 1, 2006 if the price of the Company's common stock exceeds 200% of the then applicable Conversion Price on the date of conversion and for at least 20 trading days over the preceding 30 trading days. The Company has the right to repurchase the Notes after May 1, 2007 at 103% of the face amount during 2007, 102% of the face amount during 2008, 101% of the face amount during 2009 and 100% of the face amount thereafter. The Notes are unsecured general obligations of the Company and are subordinated to all other indebtedness of the Company unless the other indebtedness is expressly made subordinate to the Notes. The Company calculated the beneficial conversion feature for the convertible notes and the amount was not material.

The Notes were offered and sold in private placement transaction pursuant to the exemption from registration provided by Section 4(2) of the Securities Act of 1933 and Rule 506 promulgated thereunder. Each of the investors is either an "accredited investor", as defined in Rule 501 promulgated under the Securities Act, or a "qualified institutional buyer", as defined in Rule 144A.

Pursuant to the terms of the Purchase Agreements, the Company and the investors entered into Registration Rights Agreements under which the Company agreed to file with the Securities and Exchange Commission, within 90 days, a registration statement covering the Notes and the common stock underlying the Notes and to use its best efforts to cause the registration statement to become effective within 180 days.

In connection with the placement of the Notes, the Company issued to the placement agent in the offering a three year warrant (the "Placement Agent Warrant") to purchase 191,250 shares of the Company's common stock at $1.00 per share and paid commissions totaling $127,500. The Registration Rights Agreements provide that the shares of common stock underlying the Placement Agent Warrant are to be included in the registration statement required to be filed.

NOTE 5. - DERIVATIVE LIABILITIES

In conjunction with the issuance of the Notes, the conversion feature, the conversion price, reset provision and the Company's optional early redemption right in the Notes have been bundled together as a single compound embedded derivative liability and, using a layered discounted probability-weighted cash

flow approach, was initially fair valued at $2,368,485 at May 4, 2005. The fair value model comprises multiple probability-weighted scenarios under various assumptions reflecting the economics of the Notes, such as the risk-free interest rate, expected Company stock price and volatility, likelihood of conversion and or redemption, and likelihood default status and timely registration. At inception, the fair value of this single compound embedded derivative was bifurcated from the host debt contract and recorded as a derivative liability which resulted in a reduction of the initial notional carrying amount of the Notes (as unamortized discount which will be amortized over a five-year period under the effective interest method). At inception the excess of the unamortized discount over the notional amount of the Note in the amount of $285,547 was charged to expense in the Company's statement of operations.

At September 30, 2005, the Notes comprised the following:

Notional balance of Convertible Notes at September 30, 2005	$ 2,125,000
Adjustment - Discount for single compound derivative liability	(2,105,794)
Convertible Notes balance at September 30, 2005, as adjusted	$ 19,206

For the period from inception (May 4, 2005) through September 30, 2005, the amortization of unamortized discount on the Notes was $19,206, which has been classified as interest expense in the accompanying statement of operation.

The Derivative Liability reflected on the balance sheet at September 30, 2005 consists of the Derivative Liability-Compound Embedded Derivatives within the Notes plus the Derivative Liability-Compound Embedded Derivatives within the Warrants issued in conjunction with the Notes.

The Derivative Liability-Compound Embedded Derivatives within Notes reflect the following activity for the period from Inception (May 4, 2005) through September 30, 2005:

Balance at inception (May 4, 2005)	$2,368,485
Mark-to-market adjustment for the period from inception to September 30, 2005	3,022
Balance at September 30, 2005	2,371,507

The Derivative Liability-Compound Embedded Derivatives within Warrants reflect the following activity for the period from inception (May 4, 2005) to September 30, 2005.

Balance at inception (May 4, 2005)	$ 42,063
Mark-to-market adjustment for the period from inception to	

September 30, 2005	348,221
Balance at September 30, 2005	390,284

NOTE 6. - WARRANTS

Activity of warrants during the nine months ended September 30, 2005 is as follows:

	Warrants	Weighted Average Share Price
Outstanding at beginning of period	-	-
Granted	191,250	$ 1.00
Outstanding at end of period	191,250	$ 1.00

Warrants outstanding and exercisable as of September 30, 2005:

Exercise Price	Number of Shares	Remaining Life	Number of Shares
1.00	191,250	2.58	191,250

NOTE 7. - FINANCING COSTS

In conjunction with the issuance of long-term debt described in Note 4 above, the Company paid $127,500

in commissions and issued a warrant to the placement agent to purchase 191,250 shares of the Company's common stock at an exercise price of $1.00 per share expiring May 3, 2008. The market price on the date the warrants were granted was $0.85. The warrants are accounted for as derivative instruments pursuant to SFAS 133 and EITF 00-19 (see Note 5 above).

The aggregate financing costs of $127,500, comprised of commissions, are being expensed ratably over the life of the Notes as financing costs. $6,386 and $10,431 of financing costs were expensed during the quarter and nine months ended September 30, 2005. Unamortized financing costs of $117,059 are classified as other assets.

NOTE 8 - CONTINGENCIES

The Company has entered into a settlement agreement with the bankruptcy estate of Moose Oil and Gas Company pursuant to which the Company paid $25,000 to the estate in full and final settlement of all claims asserted against the Company.

The trustee in the bankruptcy has approved the settlement. The settlement will become final upon passage of a waiting period subject to the right of creditors to contest the settlement during the waiting period.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

FORWARD-LOOKING INFORMATION

This Form 10-QSB quarterly report of Houston American Energy Corp. (the "Company") for the nine months ended September 30, 2005, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. To the extent that there are statements that are not recitations of historical fact, such statements constitute forward-looking statements that, by definition, involve risks and uncertainties. In any forward-looking statement, where the Company expresses an expectation or belief as to future results or events, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the statement of expectation or belief will be achieved or accomplished.

The following are factors that could cause actual results or events to differ materially from those anticipated, and include, but are not limited to: general economic, financial and business conditions; the Company's ability to minimize expenses and exposures related to its oil and gas properties in which other companies have control over the operations conducted on such properties; changes in and compliance with governmental laws and regulations, including various state and federal environmental regulations; and the Company's ability to obtain additional necessary financing from outside investors and/or bank and mezzanine lenders.

Readers are cautioned not to place undue reliance on the forward-looking statements contained herein, which speak only as of the date hereof. The Company believes the information contained in this Form 10-QSB to be accurate as of the date hereof. Changes may occur after that date, and the Company will not update that information except as required by law in the normal course of its public disclosure practices.

The oil and gas industry is subject to volatile price movements based on various factors including supply and demand and other factors beyond the control of the Company. While the industry has generally benefited from higher prices during the past two years, sudden and/or sustained decreases in energy prices can occur, which could limit our ability to fund planned levels of capital expenditures.

Additionally, the following discussion regarding the Company's financial condition and results of operations should be read in conjunction with the financial statements and related notes contained in Item 1 of Part 1 of this Form 10-QSB, as well as the financial statements in Item 7 of Part II of the Company's Form 10-KSB for the fiscal year ended December 31, 2004.

CRITICAL ACCOUNTING POLICIES

The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company believes certain critical accounting policies affect its more significant judgments and estimates used in the preparation of its financial statements. A description of the Company's

critical accounting policies is set forth in the Company's Form 10-KSB for the year ended December 31, 2004. As of, and for the quarter ended, September 30, 2005, there have been no material changes or updates to the Company's critical accounting policies other than (1) the application of derivative accounting treatment prescribed by SFAS 133 and EITF 00-19 to outstanding convertible notes and warrants, and (2) the following updated information relating to Unevaluated Oil and Gas Properties:

-- UNEVALUATED OIL AND GAS PROPERTIES. Unevaluated oil and gas properties not subject to amortization include the following at September 30, 2005:

Acquisition costs	$ 86,300
Evaluation costs	627,983
Total	$714,283

The carrying value of unevaluated oil and gas prospects include $442,936 expended for properties in the South American country of Colombia at September 30, 2005. We are maintaining our interest in these properties and development has or is anticipated to commence within the next twelve months.

-- DERIVATIVES. The Company determined that the convertible notes and warrants issued during 2005 contain detachable and embedded derivatives that should have been accounted for as derivative instruments in accordance with SFAS 133 and EITF 00-19. In assessing the value of the derivative instruments in accordance with SFAS 133 and EITF 00-19, the Company utilizes a fair value model comprised of multiple probability-weighted scenarios under various assumptions reflecting the economics of the Convertible Notes, such as the risk-free interest rate, expected Company stock price and volatility, likelihood of conversion and or redemption, and likelihood default status and timely registration. Changes in the subjective assumptions can materially affect the estimated fair value of derivative instruments and consequently, the related amounts recognized in the financial statements. See Note 5 of the Notes to the Financial Statements in this Form 10-QSB for further discussion of derivative instruments.

CURRENT YEAR DEVELOPMENTS

Drilling, Leasehold and Seismic Activity

Through November 10, 2005, the Company has drilled two on-shore domestic wells as follows:

- Drilling of a 10,600-foot well, the first well, on the South Sibley Prospect in Webster Parish, Louisiana was completed in May 2005 with multiple pay sands apparently identified. Sales from the well commenced June 28, 2005. The Company has a 7.5% working interest at an 8.3% net revenue interest carried to point of sales for the well.

- Drilling of a 12,100-foot well, the Baronet #2 well, on the Crowley Prospect in Acadia Parish, Louisiana was completed in April 2005. The well tested the Hayes Sand and flanks a natural gas well that produced 1.6 BCF of natural gas from the Hayes Sand. After logging 21-feet of apparent net pay, hole conditions deteriorated before logging could be completed. The well was completed and production began in June 2005. The Company has a 3%

working interest and 2.25% net revenue interest until payout for the well.

Assuming the Baronet #2 performs consistently, the Company plans to drill a developmental well on the Crowley Prospect during the first quarter of 2006.

Through November 10, 2005, the Company had acquired interests in four additional domestic prospects: (1) a 8.25% working interest with a 6.1875% net revenue interest, subject to a 25% working interest back in at payout, in the 425 acre Sugarland Prospect in Vermillion Parish, Louisiana; (2) a 4.375% working interest, subject to payment of 5.8334% of costs to the casing point in the first well, in the 500 acre Hog Heaven Prospect in Jim Hogg County, Texas; (3) a 15% working interest with an 11.25% net revenue interest in the 1340 acre Obenhaus Prospect in Wilbarger County, Texas; and (4) a 15% working interest with an 11.25% net revenue interest in the 900 acre West Fargo Prospect in Wilbarger County, Texas. Subject to rig availability, the Company plans to commence drilling on each of these prospects before the end of 2005.

Through November 10, 2005, the Company has drilled nine international wells in Colombia as follows:

- Drilling of 8 offset wells on the Cara Cara concession in Colombia was completed with production commencing on the Bengala #4, #5, #6, #7ST and #8 and the Jaguar #5, #T5 and #T6. The Company holds a 1.59% working interest in each of the wells subject to a 30% reversionary interest to Ecopetrol at payout.

- The Tambaqui #5 well commenced drilling, and production began, in March 2005. The Company holds a 12.6% working interest in the well.

Seismic surveying began on our Cara Cara concession in Colombia as part of our planned delineation of additional drilling prospects on the concession. Seismic surveying was completed on our Dorotea and Cabiona concessions to establish drilling prospect locations.

The Company and its partners plan to drill up to 2 additional wells on the Cara Cara concession through the end of 2005.

The Company and its partners are permitting 30 drilling locations on the Dorotea and Cabiona contract. The Company and its partners plan to add a second rig to begin drilling the first well in the Cabiona and Dorotea contracts in the first quarter of 2006.

Through November 10, 2005, the Company and its partners had also acquired an additional drilling concession, known as the Surimena concession, in Colombia covering approximately 108 square miles. The Company's net working interest in the Surimena concession is 12.5%. Based on 2D seismic interpretation, drilling on the Surimena concession is expected to commence in mid-2006.

Financing Activity

In May 2005, the Company sold $2,125,000 of 8% Subordinated Convertible Notes Due 2010 (the "Notes").

The Notes bear interest at 8%, provide for semi-annual interest payments and mature May 1, 2010. The Notes are convertible, at the option of the holders, into common stock of the Company at a price of $1.00 per share (the "Conversion Price"), subject to standard anti-dilution provisions relating to splits, reverse splits and other transactions, including issuances of common stock at prices below the Conversion Price. The Notes are subject to automatic

conversion in the event the Company conducts an underwritten public offering of its common stock from which the Company receives at least $5 million and the public offering price is at least 150% of the then applicable Conversion Price. The Company has the right to cause the Notes to be converted into common stock after May 1, 2006 if the price of the Company's common stock exceeds 200% of the then applicable Conversion Price on the date of conversion and for at least 20 trading days over the preceding 30 trading days. The Company has the right to repurchase the Notes after May 1, 2007 at 103% of the face amount during 2007, 102% of the face amount during 2008, 101% of the face amount during 2009 and 100% of the face amount thereafter. The Notes are unsecured general obligations of the Company and are subordinated to all other indebtedness of the Company unless the other indebtedness is expressly made subordinate to the Notes. The Company calculated the beneficial conversion feature for the convertible notes and the amount was not material.

Pursuant to the terms of the Purchase Agreements, the Company and the investors entered into Registration Rights Agreements under which the Company agreed to file with the Securities and Exchange Commission, within 90 days, a registration statement covering the Notes and the common stock underlying the Notes and to use its best efforts to cause the registration statement to become effective within 180 days.

In connection with the placement of the Notes, the Company issued to the placement agent in the offering a three year warrant (the "Placement Agent Warrant") to purchase 191,250 shares of the Company's common stock at $1.00 per share and paid commissions totaling $127,500. The Registration Rights Agreements provide that the shares of common stock underlying the Placement Agent Warrant are to be included in the registration statement required to be filed.

RESTATEMENT OF FINANCIAL STATEMENTS

The financial statements as of September 30, 2005 and for the three-month and nine-month periods ended September 30, 2005 are restated from those originally issued to reflect certain adjustments related to derivative financial instruments.

The restatement relates to the accounting for embedded features in the Notes and Placement Agent Warrants issued by the Company during 2005. The Notes were originally recorded at their notional amounts; and the fair value of the Placement Agent Warrants were included in Shareholders' Equity. The Company subsequently determined that the Notes and Placement Agent Warrants contain detachable and embedded derivatives that should have been accounted for as derivative financial instruments in accordance with SFAS 133 and EITF 00-19.

In connection with the referenced restatement, interest income and certain financing costs have been reclassified from operating revenue and expense, respectively, to other (income) expense.

RESULTS OF OPERATIONS

Oil and Gas Revenues. Total oil and gas revenues increased 171% to $1,824,582 in the nine months ended September 30, 2005 when compared to the nine months ended September 30, 2004. The increase in

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revenue is due to (1) increased production resulting from the development of the Columbian fields and the new domestic wells that have come on line during the fourth quarter of 2004 and the first nine months of 2005, and (2) increases in oil prices. The Company had interests in 16 producing wells in Colombia and 8

producing wells in the U.S. during the 2005 period as compared to 7 producing wells in Columbia and 6 producing wells in the U.S. during the 2004 period. Average prices from sales were $47.81 per barrel of oil and $6.32 per mcf of gas during the 2005 period as compared to $32.22 per barrel of oil and $5.35 per mcf of gas during the 2004 period. Following is a summary comparison, by region, of oil and gas sales for the periods.

	Columbia	U.S.	Total
2005 Period			
Oil sales	$1,360,647	$ 62,978	$1,423,625
Gas sales	-	400,957	400,957
2004 Period			
Oil sales	423,614	16,489	440,103
Gas sales	-	232,719	232,719

Lease Operating Expenses. Lease operating and severance tax expenses, excluding joint venture expenses relating to our Columbian operations discussed below, increased 151% to $710,702 in the 2005 period from $283,322 in the 2004 period. The increase in lease operating expenses was attributable to the increase in the number of producing wells during the 2005 period (24 wells as compared to 11 wells). Following is a summary comparison of lease operating expenses for the periods.

	Columbia	U.S.	Total
2005 Period	$ 660,446	$50,256	$710,702
2004 Period	255,676	27,646	283,322

Joint Venture Expenses. The Company's allocable share of joint venture expenses attributable to the Colombian Joint Venture totaled $43,105 during the 2005 period and $25,637 during the 2004 period. The increase in joint venture expenses was attributable to an increase in operational activities of the joint venture in acquiring new concessions.

Depreciation and Depletion Expense. Depreciation and depletion expense was $223,392 and $88,918 for the periods ended September 30, 2005 and 2004, respectively. The increase is due to increases in domestic and Colombian production.

General and Administrative Expenses. General and administrative expense increased by 167% to $542,590 during the 2005 period from $202,906 in the 2004 period. The increase in general and administrative expense was primarily attributable to the payment of salary (up $142,836 from $0) to the Company's principal officer beginning in the fourth quarter of 2004 and increases in professional fees (up $217,078, or 230%) relating primarily to legal fees associated with the ongoing Moose Oil litigation.

Other Expense, Net. Other expense, net, consists of financing costs in the nature of interest and deemed interest associated with outstanding shareholder loans and convertible notes and warrants issued in May 2005, net of interest earned by the Company. Certain features of the convertible notes and warrants resulted in the recording of a deemed derivative liability on the balance sheet and periodic interest associated with the deemed derivative liabilities and

changes in the fair market value of those deemed liabilities.

Other expenses, in total, increased from $49,005 in the nine-month period ended September 30, 2004 to $768,764 in the nine-month period ended September 30, 2005. The increase in other expenses was attributable to interest incurred on the convertible notes issued in May 2005 and deemed interest and related charges associated with the derivative liability. During the 2004 period, other expense was entirely

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attributable to interest accruing on a shareholder loan ($54,000) offset by earned interest ($4,995). During the 2005 period, other expense related primarily to deemed interest on the derivative liability ($304,753), the net change in fair value of the derivative liability ($351,244), interest accrued on the convertible notes ($69,420), interest accrued on the shareholder loan ($54,000) and financing costs ($10,431), offset by interest earnings ($21,084).

FINANCIAL CONDITION

Liquidity and Capital Resources. At September 30, 2005 we had a cash balance of $1,790,184 and working capital of $1,906,608 compared to a cash balance of $721,613 and working capital of $771,392 at December 31, 2004. The increase in cash and working capital during the period was primarily attributable to the sale, during 2005, of $2,125,000 of Subordinated Convertible Notes partially offset by investing activities relating to oil and gas properties.

Derivative liabilities of $2,761,791 are recorded as current liabilities at September 30, 2005 as compared to $0 at December 31, 2004 but are not considered in computing working capital. The derivative liabilities represent the deemed fair value of the embedded derivatives included in the subordinated convertible notes and accompanying warrants that were issued during 2005 as measured at September 30, 2005 and December 31, 2004. Included within the derivative liabilities at September 30, 2005 was $2,105,794 attributable to the derivative features in the subordinated convertible notes which amount is reflected as a discount in the amount of the subordinated convertible note on the balance sheet as compared to $0 at December 31, 2004.

Operating cash flows for the 2005 period totaled $296,656 as compared to $133,483 during the 2004 period. The improvement in operating cash flow was primarily attributable to improved profitability and increases in depreciation and depletion, partially offset by changes in operating assets and liabilities.

Investing activities used $1,353,085 during the 2005 period as compared to $567,513 used during the 2004 period. The increase in funds used in investing activities during the current period was primarily attributable to the payment of the Company's portion of seismic survey costs on Colombian prospects totaling $453,198.

Financing activities provided $2,125,000 during the 2005 period attributable to the sale of Subordinated Convertible Notes and $91,193 during the 2004 period attributable to the issue of common stock.

Long-Term Debt. At September 30, 2005, our long-term debt was $1,063,412 as compared to $1,000,000 at December 31, 2004. Long-term debt at September 30, 2005 consisted of a reserve for plugging costs of $44,456, a note payable to our principal shareholder in the amount of $1,000,000 and 8% subordinated convertible notes in the principal amount of $2,125,000, recorded net of discounts in the amount of $2,105,794 relating to the fair value of the embedded derivatives included in the subordinated convertible notes. The increase in long-term debt was attributable to the issuance during the period of the

subordinated convertible notes and recording the plugging cost reserve.

Notes payable to our principal shareholder, in the amount of $1,000,000, bear interest at 7.2% and mature January 1, 2007.

Notes payable also included $2,125,000 in principal amount of Convertible Notes. The Convertible Notes bear interest at 8%, provide for semi-annual interest payments and mature May 1, 2010. The Convertible Notes are convertible, at the option of the holders, into common stock of the Company at a price of $1.00 per share (the "Conversion Price"), subject to standard anti-dilution provisions relating to splits, reverse splits and other transactions, including issuances of common stock at prices below the Conversion Price.

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The Convertible Notes are subject to automatic conversion in the event the Company conducts an underwritten public offering of its common stock from which the Company receives at least $5 million and the public offering price is at least 150% of the then applicable Conversion Price. The Company has the right to cause the Convertible Notes to be converted into common stock after May 1, 2006 if the price of the Company's common stock exceeds 200% of the then applicable Conversion Price on the date of conversion and for at least 20 trading days over the preceding 30 trading days. The Company has the right to repurchase the Convertible Notes after May 1, 2007 at 103% of the face amount during 2007, 102% of the face amount during 2008, 101% of the face amount during 2009 and 100% of the face amount thereafter. The Convertible Notes are unsecured general obligations of the Company and are subordinated to all other indebtedness of the Company unless the other indebtedness is expressly made subordinate to the Convertible Notes.

Capital and Exploration Expenditures and Commitments. Our principal capital and exploration expenditures relate to our ongoing efforts to acquire, drill and complete prospects. Historically, we funded our capital and exploration expenditures from funds borrowed from John F. Terwilliger, our principal shareholder and officer. With the receipt of additional equity financing in 2003, 2004 and the May 2005 sale of convertible notes, and the increase in our revenues, profitability and operating cash flows, we expect that future capital and exploration expenditures will be funded principally through funds on hand and funds generated from operations.

During the first nine months of 2005, we invested approximately $1,353,085 for the acquisition and development of oil and gas properties, consisting of (1) seismic surveying in Colombia ($453,198), (2) drilling the well on the Crowley Prospect, and (3) drilling 9 wells in Colombia.

At September 30, 2005, our only material contractual obligations requiring determinable future payments on our part were notes payable to our principal shareholder and holders of subordinated convertible notes and our lease relating to our executive offices.

In addition to the contractual obligations requiring that we make fixed payments, in conjunction with our efforts to secure oil and gas prospects, financing and services, we have, from time to time, granted overriding royalty interests (ORRI) in various properties, and may grant ORRIs in the future, pursuant to which we will be obligated to pay a portion of our interest in revenues from various prospects to third parties.

At September 30, 2005, our acquisition and drilling budget for the balance of 2005 totaled approximately $392,000, consisting of (1) $50,000 for drilling of 2 wells in South America on the Cara Cara concession, and (2) $342,000 to drill 4 domestic wells on the Sugarland Prospect, the Hog Heaven Prospect, the Obenhaus

Prospect and the West Fargo Prospect. Our acquisition and drilling budget has historically been subject to substantial fluctuation over the course of a year based upon successes and failures in drilling and completion of prospects and the identification of additional prospects during the course of a year.

Management anticipates that our current financial resources combined with our increases in revenues over the past year will meet our anticipated objectives and business operations, including our planned property acquisitions and drilling activities, for at least the next 12 months without the need for additional capital. Management continues to evaluate producing property acquisitions as well as a number of drilling prospects. It is possible, although not anticipated, that the Company may require and seek additional financing if additional drilling prospects are pursued beyond those presently under consideration.

OFF-BALANCE SHEET ARRANGEMENTS

We had no off-balance sheet arrangements or guarantees of third party obligations at September 30, 2005.

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INFLATION

We believe that inflation has not had a significant impact on our operations since inception.

ITEM 3. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e) and 15d-15(e)) that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

At the time the original Quarterly Report on Form 10-Q was prepared and filed on November 14, 2005, an evaluation as of the end of the period covered by this report had been carried out under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d -15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This evaluation was performed in light of weaknesses identified, and described in the original Quarterly Report, relating to accounting for non-routine transactions. Based on their evaluation, our chief executive officer, who also served at that time as chief financial officer, had originally concluded that our disclosure controls and procedures were effective to ensure that we record, process, summarize, and report information required to be disclosed by us in our reports filed under the Securities Exchange Act within the time periods specified by the Securities and Exchange Commission's rules and forms even though weaknesses in controls were identified.

In connection with the audit of our financial statements for the fiscal year ended December 31, 2005, our independent registered public accounting firm informed us that we had significant deficiencies constituting material weaknesses as defined by the standards of the Public Company Accounting Oversight Board, some of which had previously been identified in connection with the audit of our financial statements for the fiscal year ended December 31, 2004 and continued to exist at December 31, 2005.

The weaknesses in question were detected during the audit of our financial statements for the fiscal year ended December 31, 2004, which audit occurred in February/March 2005, and during the audit of our financial statements for the fiscal year ended December 31, 2005, which audit occurred in March 2006.

The weaknesses were detected in the routine course of the audit review of accounting for certain non-routine transactions.

The specific problems identified by the auditor were (1) lack of segregation of duties necessary to maintain proper checks and balances between functions, (2) failure of internal personnel to adequately communicate the scope and nature of non-routine transactions, and (3) application of improper accounting principles to financial derivatives. The absence of qualified full time accounting personnel was a contributing factor to the problems identified by the auditor. The specific circumstances giving rise to the weaknesses include

our President serving as both Chief Executive Officer and as Chief Financial Officer and our utilizing the services of contract accountants on a part time basis in the absence of internal accounting personnel. As a result of the absence of full time in-house accounting personnel and the failure of in-house personnel to adequately communicate information to the outside contract accountants, certain journal entries required during 2004 and 2005 were not made until the time of the audit when the need for such entries was identified by the auditor.

As a result of our review of the items identified by our auditors, we have concluded that our previous derivative accounting policies were incorrect.

In light of the above items, we have restated our financial statements for the quarterly and year-to-date periods ended June 30, 2005 and September 30, 2005 to correct our accounting for derivatives.

Further, based on the material weaknesses described herein, we have re-evaluated our disclosure controls at September 30, 2005 and concluded that our disclosure controls and procedures were not effective at the reasonable assurance level at September 30, 2005. More specifically, our failure to maintain effective controls over the selection, application and monitoring of our accounting policies to assure that certain transactions were accounted for in conformity with generally accepted accounting principles resulted in a failure to record an appropriate derivative liability, deemed interest expense associated with the derivative liability and related charges associated with changes in the value of embedded derivatives, all arising from the issuance of convertible notes and warrants that included embedded derivatives.

Because we lack the financial resources to support in-house accounting personnel at this time, no formal steps had been taken as of the time of filing of the original quarterly report for the period ended September 30, 2005 to resolve the weaknesses identified by the auditor. We, however, began emphasizing improvement in communications with outside accounting personnel to assure that non-routine transactions are accounted for in a timely manner. Further, with respect to the specific accounting principles that were subject of the

weaknesses identified - derivatives accounting and compensation accounting - we placed an emphasis on reviewing the application of such principles in connection with all future accounting periods.

During the quarter ended September 30, 2005, there were no changes in our internal controls over financial reporting that materially affected, or are reasonably likely to materially affect, internal controls over financial reporting. We subsequently hired a full-time in-house chief financial officer and expect that such hiring will alleviate some or all of the weaknesses in disclosure control previously identified.

PART II

ITEM 1. LEGAL PROCEEDINGS

The Company has entered into a settlement agreement with the bankruptcy estate of Moose Oil and Gas Company pursuant to which the Company paid $25,000 to the estate in full and final settlement of all claims asserted against the Company. The trustee in the bankruptcy has approved the settlement. The settlement will become final upon passage of a waiting period subject to the right of creditors to contest the settlement during the waiting period.

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ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of CEO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant t of the Sarbanes-Oxley Act of 2002
32.2	Certification of CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant t of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

HOUSTON AMERICAN ENERGY CORP.

By: /s/ John Terwilliger
John Terwilliger
CEO and President

By: /s/ James Jacobs
James Jacobs
Chief Financial Officer

Date: November 17, 2006

S June 30, December 31, 2002 2001 --------- ------------ ASSETS Cash $ 27,671 $ 28,612 Investment securities available-for-sale 94 3,394 Mortgage loans held-for-sale 241,057 174,172 Mortgage servicing rights 7,820 8,468 Premises and equipment, net 4,927 5,333 Accrued interest receivable 240 130 Other assets 30,062 19,693 --------- --------- Total assets $ 311,871 $ 239,802 ========= ========= LIABILITIES AND SHAREHOLDERS' EQUITY Borrowings from IWLG $ 238,425 $ 174,136 Due to affiliates 14,500 14,500 Deferred revenue 3,779 4,479 Accrued interest expense 336 453 Other liabilities 32,701 26,914 --------- --------- Total liabilities 289,741 220,482 --------- --------- Shareholders' Equity: Preferred stock 18,053 18,053 Common stock 182 182 Retained earnings 18,885 8,722 Cumulative dividends declared (14,734) (8,984) Accumulated other comprehensive gain (loss) (256) 1,347 --------- --------- Total shareholders' equity 22,130 19,320 --------- --------- Total liabilities and shareholders' equity $ 311,871 $ 239,802 ========= ========= STATEMENTS OF OPERATIONS For the Three Months For the Six Months Ended June 30, Ended June 30, --------------------- --------------------- 2002 2001 2002 2001 -------- -------- -------- -------- Interest income $ 7,926 $ 5,253 $ 14,572 $ 12,745 Interest expense 5,916 4,774 10,891 11,972 -------- -------- -------- -------- Net interest income 2,010 479 3,681 773 Gain on sale of loans 19,574 12,875 35,732 20,523 Loan servicing income (391) 769 (748) 1,800 Other non-interest income 346 65 2,080 112 -------- -------- -------- -------- Total non-interest income 19,529 13,709 37,064 22,435 Personnel expense 6,270 3,453 11,843 6,638 General and administrative and other expense 4,368 3,382 8,457 5,655 Amortization of mortgage servicing rights 993 1,188 2,493 2,445 Provision for repurchases 395 8 830 14 Mark-to-market loss - FAS 133 (8) -- (456) (17) -------- -------- -------- -------- Total non-interest expense 12,018 8,031 23,167 14,735 Earnings before income taxes and cumulative effect of change in accounting principle 9,521 6,157 17,578 8,473 Income taxes (4,013) (2,608) (7,415) (3,609) -------- -------- -------- -------- Earnings before cumulative effect of change in accounting principle 5,508 3,549 10,163 4,864 Cumulative effect of change in accounting principle -- -- -- 17 -------- -------- -------- -------- Net earnings 5,508 3,549 10,163 4,847 Less: Cash dividends on preferred stock (3,713) (2,475) (5,693) (4,419) -------- -------- -------- -------- Net earnings available to common stockholders $ 1,795 $ 1,074 $ 4,470 $ 428 ======== ======== ======== ======== 15 10. Accounts Receivable An accounting entry for $132.5 million was recorded to accounts receivable for the pre-funding of the CMO that was completed on June 26, 2002. Pre-funding allows the Company to complete a securitized transaction and lock-in financing terms and conditions before mortgage loans securing CMOs are delivered to the trustee. However, the Company must establish a pre-funding account with the trustee whereby all or a portion of the proceeds of the sale of one or more classes of bonds created by the CMO will be deposited in the account to be released as additional mortgage loans are transferred. As of July 31, 2002, mortgage loans were transferred to the trustee thereby satisfying all requirements of the pre-funding arrangement. 11. Stockholders' Equity During the six months ended June 30, 2002, accumulated other comprehensive losses increased by $10.0 million due to a $9.3 million increase in unrealized loss on derivative assets and a $711,000 increase in unrealized loss on investment securities available-for-sale. During the six months ended June 30, 2002, the Company issued 7.4 million shares of common stock and received net proceeds of $57.0 million. During the three months ended June 30, 2002, the Company sold 489,300 shares of common stock pursuant to its sales agency agreement which provided net proceeds of approximately $5.5 million. On June 25, 2002, the Company declared a second quarter cash dividend of $0.43 per common share, or $17.2 million, which was paid on July 12, 2002 to common stockholders of record on July 3, 2002. On March 26, 2002, the Company declared a first quarter cash dividend of $0.40 per common share, or $15.8 million, which was paid on April 16, 2002 to common stockholders of record on April 3, 2002. 12. Subsequent Events On July 17, 2002, the Company filed an Articles of Amendment with the State Department of Assessments and Taxation of Maryland on increasing authorized shares of Common Stock. The increase was approved by the shareholders on June 25, 2002. 16 Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations This Quarterly Report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements, some of which are based on various assumptions and events that are beyond our control, may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate,"

"continue," or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to, adverse economic conditions, the ability to generate sufficient liquidity, including completing securitizations and earning interest on our mortgage loans, different interest rate fluctuations on our assets and liabilities, changes in the difference between short-term and long-term interest rates, increase in prepayment rates on our mortgage assets, changes in assumptions regarding estimated loan losses, the availability of financing and, if available, the terms of any financing. For a discussion of the risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements refer to "Risk Factors" in this Quarterly Report. We do not undertake, and specifically disclaim any obligation, to publicly release the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements. The terms "Company," "we," "us," and "our" refer to Impac Mortgage Holdings, Inc., a Maryland corporation incorporated in August 1995, and its subsidiaries, IMH Assets Corp., or "IMH Assets," Impac Warehouse Lending Group, Inc., or "IWLG," and its affiliate, Impac Funding Corporation, or "IFC," together with its wholly-owned subsidiaries Impac Secured Assets Corporation and Novelle Financial Services, Inc. References to Impac Mortgage Holdings, Inc., or "IMH," are made to differentiate IMH, the publicly traded company, as a separate entity from IMH Assets, IWLG and IFC. IMH is a mortgage real estate investment trust ("REIT"). Together with our subsidiaries and affiliate, IFC, we are a nationwide acquirer, originator, securitizer and investor of primarily non-conforming Alt-A mortgage loans ("Alt-A"). Alt-A mortgage loans consist primarily of mortgage loans that are first lien mortgage loans made to borrowers whose credit is generally within typical Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") guidelines, but that have loan characteristics that make them non-conforming under those guidelines. For instance, the Alt-A mortgage loans may have higher loan-to-value LTV ratios than allowable or may have excluded certain documentation or verifications. Therefore, in making credit decisions, we are more reliant upon the borrower's credit score and the adequacy of the underlying collateral. Alt-A credit quality loans generally have a credit score of 600 or better while "A" credit quality loans generally have a credit score of 640 or better. We believe that the non-conforming Alt-A mortgage market is expanding because this market niche provides mortgage borrowers with valuable financing alternatives to Fannie Mae, Freddie Mac and sub-prime lenders. We also believe that Alt-A mortgage loans provide an attractive net earnings profile by producing higher yields without commensurately higher credit losses than other types of mortgage loans. Since 1999, we have acquired and originated primarily Alt-A mortgage loans. We also provide warehouse and repurchase financing to originators of mortgage loans. Our ultimate goal is to generate consistent and reliable income for distribution to our stockholders primarily from the earnings of our long-term investment operations. Critical Accounting Policies Certain accounting policies require us to make significant estimates and assumptions, which have a material impact on the carrying value of certain assets and liabilities, and we consider these to be critical accounting policies. The estimates and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods. We believe the following are critical accounting policies that require the most significant estimates and assumptions that are particularly susceptible to significant change in the preparation of our financial statements: o Allowance for losses on loans. For further information, see note 7 on page 12 of notes to consolidated financial statements and pages 21 and 22 of this section; and 17 o Accounting for Derivative Instruments and Hedging Activities. For further information, see note 4 on pages 9 and 10 of notes to consolidated financial statements and "Item 3. Quantitative and Qualitative Disclosures About Market Risk" on page 45. Significant Transactions On February 7, 2002, IMH issued 7.4 million shares of common stock at a price of $8.25 per share and received net proceeds of $57.0 million. On March 26, 2002, IMH declared a first quarter cash dividend of $0.40 per common share, or $15.8 million, which was paid on April 16, 2002 to common stockholders of record on April 3, 2002. On June 25, 2002, IMH declared a second quarter cash dividend of $0.43 per common share, or $17.2 million, which was paid on July 12, 2002 to common stockholders of record on July 3, 2002. During the three months ended June 30, 2002, IMH issued and sold 489,300 shares of common stock pursuant to its sales agency agreement at an average net price of $11.21 per share, which provided net proceeds of approximately $5.5 million. Operating Segments We primarily operate three core businesses: the long-term investment operations, the mortgage operations, and the warehouse lending operations. Long-Term Investment

Operations The long-term investment operations, conducted by IMH and IMH Assets, invest primarily in Alt-A mortgage loans. This business primarily generates net interest income on its mortgage investment portfolio and, to a lesser extent, its investment securities portfolio. Alt-A mortgage loans are financed with collateralized mortgage obligations ("CMOs"), warehouse facilities and proceeds from the sale of capital stock. During the first six months of 2002, the long-term investment operations acquired $1.6 billion of primarily Alt-A adjustable-rate mortgages ("ARMs") secured by first liens on residential property from the mortgage operations. Of the Alt-A mortgages acquired during the first six months of 2002, 72% were acquired with prepayment penalty features with a weighted average coupon of 6.56% and a weighted average credit score of 684. As of June 30, 2002, the long-term mortgage investment portfolio was $3.4 billion of which approximately 94% were ARMs and 6% were fixed rate mortgages ("FRMs"). The long-term mortgage investment portfolio had a weighted average coupon of 7.13%, a weighted average margin of 3.15% and an original weighted average credit score of 676. Ninety-six percent of long-term mortgage investment portfolio were Alt-A mortgages, 65% had prepayment penalty features with a weighted average expiration period of 22 months and 50% were six-month London Interbank Offered Rate ("LIBOR") indexed hybrid loans ("six month hybrids"). Six months hybrids have initial fixed interest rate periods of two to five years, which subsequently adjust to ARMs, and had an average interest rate adjustment period of approximately 13 months as of June 30, 2002. Mortgage Operations The mortgage operations, conducted by IFC, acquire, originate, sell and securitize primarily Alt-A mortgage loans and, to a lesser extent, sub-prime mortgage loans ("B/C loans"). The mortgage operations generate income by securitizing and selling loans to permanent investors, including the long-term investment operations. This business also earns revenues from fees associated with mortgage servicing rights, master servicing agreements and interest income earned on loans held for sale. The mortgage operations primarily use warehouse lines of credit to finance the acquisition and origination of mortgage loans. Loan acquisitions and originations by the mortgage operations were $2.6 billion during the first six months of 2002. Of mortgages acquired or originated during the first six months of 2002, 75% had prepayment penalty features and 69% were ARMs. During the first six months of 2002, the mortgage operations sold $1.6 billion of mortgage loans to the long-term investment operations, issued real estate mortgage investment conduits ("REMICs") totaling $594.7 million and sold $308.6 million of mortgage loans to first party investors. As of June 30, 2002, the master servicing portfolio was $6.9 billion and the loan delinquency rate of mortgages in the master servicing portfolio which were 60 or more days past due, inclusive of foreclosures and delinquent bankruptcies, was 4.70%. 18 Warehouse Lending Operations The warehouse lending operations, conducted by IWLG, provide short-term financing to mortgage loan originators by funding mortgage loans from their closing date until they are sold to pre-approved investors. The warehouse lending operations earn fees, as well as a spread, from the difference between its cost of borrowings and the interest earned on advances. As of June 30, 2002, the warehouse lending operations had $498.0 million of short-term warehouse lines of credit available to 59 non-affiliated customers, of which $343.4 million was outstanding. Results of Operations--Impac Mortgage Holdings, Inc. For the Three Months Ended June 30, 2002 as compared to the Three Months Ended June 30, 2001 Net earnings for the second quarter of 2002 was $17.7 million, or $0.44 per diluted share, as compared to net earnings of $8.8 million, or $0.33 per diluted share, for the second quarter of 2001. Net earnings rose as net interest income increased $7.0 million due to an increase in average mortgage assets while equity in net earnings of IFC, the Company's taxable REIT subsidiary, increased $1.9 million. Net interest income increased 66% to $17.6 million during the second quarter of 2002 as compared to $10.6 million during the second quarter of 2001 as total average mortgage assets rose. Total average mortgage assets increased 85% to $3.7 billion during the second quarter of 2002 as compared to $2.0 billion during the second quarter of 2001 as the long-term investment operations acquired $2.5 billion of mortgage loans for long-term investment since the end of the second quarter of 2001. Yield on Mortgage Assets declined 221 basis points to 5.26% during the second quarter of 2002 as compared to 7.47% during the second quarter of 2001 as interest rates on mortgage loans declined. The decline in mortgage interest rates was the result of short-term interest rate reductions by the Federal Reserve Bank during 2001 and 2002 in response to a faltering economy and the events of September 11, 2001. Short-term interest rates reached historical lows during 2002. As short-term interest rates and mortgage rates declined, borrowing costs on Mortgage Assets declined as well. Yield on borrowings on Mortgage Assets declined 219 basis points to 3.58% during the second quarter of 2002 as compared to 5.77% during the second quarter of 2001. The decrease in net interest spread resulted in a 22 basis point decrease in net interest margins on Mortgage Assets to 1.85% during the second quarter of 2002 as compared to 2.07% during the second quarter of 2001. Margin compression during the second quarter of 2002 was

primarily due to the acquisition of six-month LIBOR indexed ARMs ("six month ARMs") since the end of the third quarter of 2001. Prior to the third quarter of 2001, the long-term investment operations primarily acquired six month hybrids which have initial fixed interest rate periods of two to five years and subsequently change to six month ARMs. The acquisition of six month ARMs compressed net interest margins as six month ARMs typically have lower initial interest rates than six month hybrids. The acquisition of six month ARMs dramatically changed the composition of the mortgage loan investment portfolio and reduced its weighted average coupon. However, since six month ARMs generally have longer expected durations than six month hybrids, we expect that six month ARMs will generate more consistent and reliable cash flows over a longer time horizon while at the same time reducing interest rate risk in an ever-changing interest rate environment. The acquisition of six month ARMs also compressed net interest margins as we were able to finance a higher percentage of six month ARMs securing CMOs than we could previously finance with six month hybrids as collateral for CMOs. Although this caused an overall increase in leverage on the mortgage loan investment portfolio and compressed net interest margins, we were able to efficiently use available capital and earn as comparable a return on the capital invested in six month ARMs as we previously earned on six month hybrids. In addition, because we frequently finance the acquisition of mortgage loans with CMOs, we significantly reduce our exposure to liquidity risk by converting the financing of loans from reverse repurchase agreements, which are subject to margin calls, to long-term debt financing, which are not subject to margin calls. Currently, the average amount of time between when the mortgage operations acquires and originates a mortgage loan and when the mortgage loan is securitized is 30 to 45 days. 19 We expect a favorable interest rate environment for the remainder of 2002 as the economy slowly recovers from the current recession. The Federal Reserve Bank did not raise short-term interest rates at its last meeting as it indicated that the pace of the economic recovery remains uncertain. There appears to be no imminent plans by the Federal Reserve Bank to increase short-term interest in the near term. We feel that interest rate hedging instruments that are currently in place, a significant volume of ARMs that have been acquired since the end of the third quarter of 2001 and our on-going hedging policy will help to mitigate possible adverse effects that rising interest rates may have on future earnings. The following table summarizes average balance, interest and weighted average yield on Mortgage Assets and borrowings on Mortgage Assets for the second quarters of 2002 and 2001 and includes interest income on Mortgage Assets and interest expense related to borrowings on Mortgage Assets only (dollars in thousands): For the Three Months For the Three Months Ended June 30, 2002 Ended June 30, 2001 ----------------------------------- ------------------------------------ Average Wtd. Avg Average Wtd. Avg Balance Interest Yield Balance Interest Yield ----------------------------------- ------------------------------------ Mortgage Assets Securities collateralized by mortgages $ 28,655 $ 655 9.14% $ 32,663 $ 992 12.15% Loans receivable: CMO collateral (1) 2,865,465 37,750 5.27 1,317,851 24,290 7.37 Mortgage loans held-for-investment (1) 96,062 1,231 5.13 177,195 3,108 7.02 Finance receivables: Affiliated 430,283 4,895 4.55 232,464 4,135 7.12 Non-affiliated 249,362 3,746 6.01 222,019 4,486 8.08 ----------------------- ----------------------- Total finance receivables 679,645 8,641 5.09 454,483 8,621 7.59 ----------------------- ----------------------- Total Loans receivable 3,641,172 47,622 5.23 1,949,529 36,019 7.39 ----------------------- ----------------------- Total Mortgage Assets $3,669,827 $48,277 5.26% $1,982,192 $37,011 7.47% ======================= ======================= Borrowings on Mortgage Assets CMO borrowings (2) $2,769,705 $25,524 3.69% $1,242,049 $17,175 5.53% Reverse repurchase agreements - mortgages 719,328 5,348 2.97 595,421 8,938 6.00 Borrowings secured by investment securities 10,714 475 17.73 18,189 660 14.51 ----------------------- ----------------------- Total Borrowings on Mortgage Assets $3,499,747 $31,347 3.58% $1,855,659 $26,773 5.77% ======================= ======================= Net Interest Spread (3) 1.68% 1.70% Net Interest Margin (4) 1.85% 2.07% (1) Interest income includes amortization of acquisition costs. (2) Interest expense includes amortization of securitization costs. (3) Net interest spread is calculated by subtracting the weighted average yield on total borrowings on Mortgage Assets from the weighted average yield on total Mortgage Assets. (4) Net interest margin is calculated by subtracting interest expense on total borrowings on Mortgage Assets from interest income on total Mortgage Assets and then dividing by the total average balance for Mortgage Assets. Due to the acquisition of a high percentage of mortgage loans with prepayment penalties, constant prepayment rates ("CPR") improved to 26% during the second quarter of 2002 as compared to 41% during the second quarter of 2001. CPR results from the unscheduled principal pay down or payoff of mortgage loans prior to the contractual maturity date or contractual payment schedule of the mortgage loan. Mortgage loans acquired from the mortgage operations with prepayment penalty features help to mitigate CPR and corresponding premium and securitization cost amortization as a result of refinancing activity. Loan premiums paid for acquiring mortgage loans

and securitization costs for obtaining financing are amortized to interest income and interest expense over the estimated lives of the mortgage loans or related borrowings. The long-term investment operations acquired $1.1 billion of primarily Alt-A mortgage loans from the mortgage operations during the second quarter of 2002. The following table summarizes mortgage loan acquisitions for the periods indicated (in thousands): 20 LOAN ACQUISITION SUMMARY (excludes premiums paid) For the Three Months Ended June 30, -------------------------------------- 2002 2001 ------------------ ---------------- Balance % Balance % ---------- --- -------- -- Volume by Type: Adjustable rate .... $1,095,144 100 $362,048 98 Fixed rate .... 867 0 5,679 2 ---------- -------- Total Loan Acquisitions .... $1,096,011 $367,727 ========== ======== Volume by Product: Six month LIBOR indexed ARMs .... $ 785,040 72 $ 20,954 6 Six month LIBOR indexed hybrids (1) .. 310,104 28 341,094 93 Fixed first trust deeds .... 556 0 -- Fixed second trust deeds .... 311 0 5,679 1 ---------- -------- Total Loan Acquisitions .... $1,096,011 $367,727 ========== ======== Volume by Credit Quality: Alt-A loans .... $1,091,232 100 $365,971 100 B/C loans .... 4,779 0 1,756 0 ---------- -------- Total Loan Acquisitions .... $1,096,011 $367,727 ========== ======== Volume by Purpose: Purchase .... $ 680,806 62 $233,768 64 Refinance .... 415,205 38 133,959 36 ---------- -------- Total Loan Acquisitions .... $1,096,011 $367,727 ========== ======== Volume by Prepayment Penalty: With prepayment penalty .... $ 835,124 76 $228,653 62 Without prepayment penalty .... 260,887 24 139,074 38 ---------- -------- Total Loan Acquisitions .... $1,096,011 $367,727 ========== ======== (1) Mortgage loans are fixed rate for initial two to five year periods and subsequently adjust to the indicated index plus a margin. Seventy-two percent of mortgage loans acquired by the long-term investment operations from the mortgage operations during the second quarter of 2002 were six month ARMs as compared to 6% during the second quarter of 2001. The shift from acquiring primarily six month hybrids prior to the end of the third quarter of 2001 to primarily acquiring six month LIBOR indexed ARMs reflects a widening gap between short- and long-term interest rates and adjustable- and fixed-rate mortgages and borrowers belief that short-term interest rates will not increase significantly in the near term. The acquisition for long-term investment of a higher than expected volume of ARMs from the mortgage operations has shifted projected future earnings from less reliance on gain on sale of loans as a source of revenue to net interest income generated from the mortgage loan investment portfolio. To finance the acquisition of mortgage loans during the second quarter of 2002, the long-term investment operations issued $1.2 billion of CMOs, which were primarily AAA rated bonds, and were priced on a weighted average basis of one-month LIBOR plus 42 basis points. In addition, we raised $5.5 million upon the issuance of 489,300 shares of common stock at an average net price of $11.21 per share. Common stock was sold as part of our sales agency agreement to sell up to 3,594,082 shares from time to time, at our discretion, at market prices. We continue to maintain an allowance for loan losses relative to total loans receivable at the same ratio as last year-end when total assets were $2.9 billion. We believe that maintaining sufficient levels of loan loss allowances combined with acquiring mortgages with favorable credit profiles will help to mitigate our credit risk. Allowance for loan losses increased 44% to $16.9 million as of June 30, 2002 as compared to $11.7 million as of December 31, 2001. Allowance for loan losses expressed as a percentage of loans receivable, which includes CMO collateral, mortgage loans held-for-investment and finance receivables, was 0.42% as of June 30, 2002 as compared to 0.43% as of December 31, 2001. As of June 30, 2002, total non-performing assets were $88.1 million, or 2.06% of total assets, as compared to $69.3 million, or 2.43% of total assets, as of December 31, 2001. Mortgage loans that were 60 or more days delinquent, including foreclosures and delinquent bankruptcies, was 3.10% of the long-term mortgage investment portfolio as of June 30, 2002 as compared to 3.84% as of December 31, 2001. 21 We make monthly provisions for estimated loan losses on our long-term investment portfolio as an increase to allowance for loan losses. The provision for estimated loan losses is primarily based on a migration analysis based on historical loss statistics, including cumulative loss percentages and loss severity, of similar loans in our long-term investment portfolio. The loss percentage is used to determine the estimated inherent losses in the investment portfolio. Provision for loan losses is also based on management's judgment of net loss potential, including specific allowances for known impaired loans, changes in the nature and volume of the portfolio, the value of the collateral and current economic conditions that may affect the borrowers' ability to pay. During the second quarter of 2002, provision for loan losses was $4.2 million as compared to $3.9 million for the second quarter of 2001. Actual loan losses, net of recoveries, during the second quarter of 2002 were $2.1 million as compared to actual loan losses, net of recoveries, of $2.4 million during the second quarter of 2001. Equity in net earnings of IFC increased 57% to $5.5 million during the second quarter of 2002 as compared to $3.5 million during the second quarter of 2001 as loan

acquisitions and originations and sales volume rose. Loan acquisitions and originations during the second quarter of 2002 was $1.4 billion as compared to $764.9 million during the second quarter of 2001. The increase in loan acquisitions and originations resulted in loan sales of $1.5 billion during the second quarter of 2002 and gain on sale of loans of $19.6 million as compared to loan sales of $786.4 million and gain on sale of loans of $12.9 million during the second quarter of 2001. Refer to "Results of Operations--Impac Funding Corporation" for more information on the operating results of IFC. Core Operating Earnings. Core operating earnings for the second quarter of 2002 increased to $17.7 million, or $0.44 per diluted share, as compared to core operating earnings of $10.5 million, or $0.39 per diluted share, for the second quarter of 2001. Core operating earnings reflect recurring earnings from operations and exclude one-time, non-recurring income and expense items and the effect of fair market accounting for derivative instruments and hedging activities. Core operating earnings is a concept not recognized by generally accepted accounting principles ("GAAP") and may not be comparable to core operating earnings of other companies. The following table summarizes the calculation of core operating earnings and a reconciliation of core operating earnings to net earnings (in thousands, except earnings per share amounts): For the Three Months Ended June 30, ------------------- 2002 2001 ------- ------- Net earnings .... $17,725 $ 8,783 Adjustments to net earnings: Mark-to-market loss - FAS 133 .... -- 581 Write-down on investment securities available-for-sale . -- 108 Cumulative effect of change in accounting principle .... -- 1,006 ------- ------- Core operating earnings .... $17,725 $10,478 ======= ======= Core operating earnings per share .... $ 0.44 $ 0.39 ======= ======= Estimated Taxable Earnings. Estimated taxable earnings for the second quarter of 2002 were $18.5 million, or $0.46 per diluted share, as compared to $10.4 million, or $0.38 per diluted share, during the second quarter of 2001. Estimated taxable earnings during the second quarter of 2002 were greater than net earnings per GAAP as excess provision for loan losses cannot be deducted from taxable earnings. During the second quarter of 2002, provision for loan losses of $4.2 million were in excess of actual loan charge-offs, net of recoveries, of $2.1 million. In addition, estimated taxable earnings for the second quarter of 2002 reflects a $3.7 million dividend from IFC on its after-tax net earnings of $5.5 million. The board of directors declared a cash dividend of $0.43 per share during the second quarter of 2002, which was paid on July 12, 2002 to stockholders of record on July 3, 2002. 22 The following table summarizes the calculation of estimated taxable earnings and a reconciliation of estimated taxable earnings to net earnings (in thousands, except earnings per share amounts): For the Three Months Ended June 30, --------------------- 2002 2001 -------- -------- Net earnings .... $ 17,725 $ 8,783 Adjustments to net earnings: Mark-to-market loss - FAS 133 .... -- 581 Write-down on investment securities available-for-sale .... -- 108 Loan loss provision .... 4,234 3,905 Dividends from IFC .... 3,713 2,475 Cash received from previously charged-off assets .... 473 438 Tax deduction for actual loan losses .... (2,064) (2,383) Equity in net earnings of IFC .... (5,453) (3,528) Tax difference of amortization of derivative instruments .. (140) -- -------- -------- Estimate taxable earnings (1) .... $ 18,488 $ 10,379 ======== ======== Estimated taxable earnings per share (1) .... $ 0.46 $ 0.38 ======== ======== (1) Reflects calculation of estimated taxable earnings generated by the Company during periods shown. Excludes remaining quarterly tax deduction of $2.7 million during 2001 for amortization of the termination of the Company's management agreement in 1997, the deduction for dividends paid and the availability of a deduction attributable to a net operating loss carry forward. As of December 31, 2001, the Company's estimated federal net operating loss carry forwards were $21.5 million, which expire in the year 2020, and estimated state net operating loss carry forwards of $21.5 million, which expire in the year 2010, that are available to offset future taxable income. Results of Operations-- Impac Funding Corporation For the Three Months Ended June 30, 2002 as compared to the Three Months Ended June 30, 2001 Net earnings increased 57% to $5.5 million during the second quarter of 2002 as compared to $3.5 million during the second quarter of 2001 as loan acquisitions and originations and sales volume rose. Loan acquisitions and originations increased 81% to $1.4 billion during the second quarter of 2002 as compared to $764.9 million during the second quarter of 2001. Loan acquisitions and originations during the second quarter of 2002 was driven by low mortgage rates, strong housing demand, innovative loan programs and IFC's automated underwriting system, IDASL, which enhances the origination process. The increase in loan acquisitions and originations resulted in loan sales of $1.5 billion during the second quarter of 2002 which contributed to gain on sale of loans of $19.6 million as compared to loan sales of $786.4 million which contributed gain on sale of loans of $12.9 million during the second quarter of 2001. Additionally, profit margins on mortgage loans sold during the second quarter of 2002 were more favorable as compared to profit margins on mortgage loans sold during the second

quarter of 2001. IFC's goal is to securitize loans more frequently as less capital is required, higher liquidity is maintained and less interest rate and price volatility during the mortgage loan accumulation period results. 23 The following table summarizes mortgage loan acquisitions and originations for the periods indicated (in thousands): LOAN PRODUCTION SUMMARY (excludes premiums paid) For the Three Months Ended June 30, ------------------------------------ 2002 2001 ---------------- ---------------- Balance % Balance % ------- - ------- - Volume by Type: Fixed rate .... $ 404,007 29 $401,882 53 Second trust deeds .... 24,191 2 9,843 1 Adjustable rate: Six month LIBOR ARMs .... 624,123 22,279 Six month LIBOR hybrids .... 335,098 330,865 ---------- -------- Total adjustable rate .... 959,221 69 353,144 46 ---------- -------- Total Loan Production .... $1,387,419 $764,869 ========== ======== Volume by Channel: Correspondent acquisitions .... $1,036,472 75 $593,649 78 Wholesale and retail originations ... 256,381 18 171,220 22 Novelle Financial Services .... 94,566 7 -- 0 ---------- -------- Total Loan Production .... $1,387,419 $764,869 ========== ======== Volume by Credit Quality: Alt-A loans .... $1,287,377 93 $761,211 100 B/C loans .... 100,042 7 3,658 0 ---------- -------- Total Loan Production .... $1,387,419 $764,869 ========== ======== Volume by Purpose: Purchase .... $ 839,140 60 $458,997 60 Refinance .... 548,279 40 305,872 40 ---------- -------- Total Loan Production .... $1,387,419 $764,869 ========== ======== Volume by Prepayment Penalty: With prepayment penalty .... $1,101,865 79 $509,564 67 Without prepayment penalty .... 285,554 21 255,305 33 ---------- -------- Total Loan Production .... $1,387,419 $764,869 ========== ======== Net interest income increased to $2.0 million during the second quarter of 2002 as compared to $479,000 during the second quarter of 2001 as average loans held for sale increased and net interest margins widened. Average loans held for sale increased to $450.4 million during the second quarter of 2002 as compared to $236.1 million during the second quarter of 2001 as a result of higher loan acquisitions and originations. Net interest margins increased to 2.09% during the second quarter of 2002 as compared to 1.01% during the second quarter of 2001 as interest rate spreads on FRMs and ARMs widened. Total non-interest expense increased to $12.0 million during the second quarter of 2002 as compared to $8.0 million during the second quarter of 2001. The increase in total non-interest expense was primarily due to an increase in personnel expense as staff was added to meet greater loan acquisition and origination volumes. Although non-interest expense increased during the second quarter of 2002, fully loaded expense to acquire and originate an Alt-A mortgage loan declined to 76 basis points during the second quarter of 2002 as compared to 95 basis points during the second quarter of 2001. Fully loaded expense includes both direct costs incurred to acquire and originate Alt-A mortgage loans, which includes loan origination and sales and marketing costs, and indirect costs, which includes accounting, administration, legal and information technology costs. Results of Operations--Impac Mortgage Holdings, Inc. For the Six Months Ended June 30, 2002 as compared to the Six Months Ended June 30, 2001 Net earnings for the first six months of 2002 were $33.4 million, or $0.87 per diluted share, as compared to net earnings of $9.9 million, or $0.37 per diluted share, for the same period of 2001. Net earnings rose as net interest income increased by $13.8 million, equity in net earnings of IFC increased by $5.3 million and mark-to-market losses on derivative instruments decreased by $5.8 million. Since fair market adjustments on derivative instruments, in 24 accordance with Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," were recorded to stockholders' equity during the first six months of 2002, net earnings were unaffected. During the first six months of 2001, SFAS 133 resulted in mark-to-market losses on derivative instruments and a corresponding reduction to net earnings of $5.8 million. Net interest income increased 71% to $33.2 million during the first six months of 2002 as compared to $19.4 million during the same period of 2001 as total average mortgage assets rose. Total average mortgage assets increased 74% to $3.3 billion during the first six months of 2002 as compared to $1.9 billion during the same period of 2001 as the long-term investment operations acquired $2.5 billion of mortgage loans for long-term investment since the end of the second quarter of 2001. Yield on Mortgage Assets declined 238 basis points to 5.43% during the first six months of 2002 as compared to 7.81% during the same period of 2001 as interest rates on mortgage loans declined. The decline in mortgage interest rates was the result of short-term interest rate reductions by the Federal Reserve Bank during 2001 and 2002 in response to a faltering economy and the events of September 11, 2001. Short-term interest rates reached historical lows during 2002. As short-term interest rates and mortgage rates declined, borrowing costs on Mortgage Assets declined as well. Yield on borrowings on Mortgage Assets declined 258 basis points to 3.69% during the first six months of 2002 as compared to 6.27% during the same period of 2001. The decrease in net interest spread resulted in a 3 basis point decrease in net interest margins on Mortgage Assets to 1.92% during the first six months of

2002 as compared to 1.95% during the first six months of 2001. Margin compression during the first six months of 2002 was primarily due to the acquisition of six month ARMs since the end of the third quarter of 2001. The acquisition of six month ARMs compressed net interest margins as six month ARMs typically have lower initial interest rates than six month hybrids. The acquisition of six month ARMs also compressed net interest margins as we were able to finance a higher percentage of six month ARMs securing CMOs than we could previously finance with six month hybrids as collateral for CMOs. The following table summarizes average balance, interest and weighted average yield on Mortgage Assets and borrowings on Mortgage Assets for the first six months of 2002 and 2001 and includes interest income on Mortgage Assets and interest expense related to borrowings on Mortgage Assets only (dollars in thousands): For the Six Months For the Six Months Ended June 30, 2002 Ended June 30, 2001 ----------------------------------- ----------------------------------- Average Wtd. Avg Average Wtd. Avg Balance Interest Yield Balance Interest Yield ----------------------------------- ----------------------------------- Mortgage Assets Securities collateralized by mortgages .... $ 30,500 $ 1,088 7.13% $ 34,531 $ 2,318 13.43% Loans receivable: CMO collateral .... 2,604,277 72,201 5.54 1,322,677 50,321 7.61 Mortgage loans held-for-investment .... 55,745 1,200 4.31 133,730 4,586 6.86 Finance receivables: Affiliated .... 408,175 9,185 4.50 267,523 10,783 8.06 Non-affiliated .... 244,498 7,029 5.75 183,124 7,794 8.51 ----------------------- ----------------------- Total finance receivables .... 652,673 16,214 4.97 450,647 18,577 8.24 ----------------------- ----------------------- Total Loans receivable .... 3,312,695 89,615 5.41 1,907,054 73,484 7.71 ----------------------- ----------------------- Total Mortgage Assets .... $3,343,195 $90,703 5.43% $1,941,585 $75,802 7.81% ======================= ======================= Total Mortgage Assets Borrowings on Mortgage Assets CMO borrowings .... $2,517,207 $47,930 3.81% $1,244,621 $37,767 6.07% Reverse repurchase agreements - mortgages .... 650,669 9,638 2.96 549,945 17,797 6.47 Borrowings secured by investment securities .. 11,525 1,024 17.77 19,253 1,337 13.89 ----------------------- ----------------------- Total Borrowings on Mortgage Assets .... $3,179,401 $58,592 3.69% $1,813,819 $56,901 6.27% ======================= ======================= Net Interest Spread 1.74% 1.54% Net Interest Margin 1.92% 1.95% 25 The long-term investment operations acquired $1.6 billion of primarily Alt-A mortgage loans from the mortgage operations during the first six months of 2002. The following table summarizes mortgage loan acquisitions for the periods indicated (in thousands): LOAN ACQUISITION SUMMARY (excludes premiums paid) For the Six Months Ended June 30, ----------------------------------- 2002 2001 ------------------------------ Balance % Balance % ------- - ------- - Volume by Type: Adjustable rate .... $1,586,925 100 $541,216 99 Fixed rate .... 867 0 5,679 1 ---------- -------- Total Loan Acquisitions .... $1,587,792 $546,895 ========== ======== Volume by Product: Six month LIBOR indexed ARMs ..... $1,107,973 70 $ 24,050 4 Six month LIBOR indexed hybrids .. 478,952 30 517,166 95 Fixed first trust deeds .... 556 0 -- Fixed second trust deeds .... 311 0 5,679 1 ---------- -------- Total Loan Acquisitions .... $1,587,792 $546,895 ========== ======== Volume by Credit Quality: Alt-A loans .... $1,581,158 100 $542,738 99 B/C loans .... 6,634 0 4,157 1 ---------- -------- Total Loan Acquisitions .... $1,587,792 $546,895 ========== ======== Volume by Purpose: Purchase .... $ 970,825 61 $360,891 66 Refinance .... 616,967 39 186,004 34 ---------- -------- Total Loan Acquisitions .... $1,587,792 $546,895 ========== ======== Volume by Prepayment Penalty: With prepayment penalty .... $1,136,649 72 $339,290 62 Without prepayment penalty .... 451,143 28 207,605 38 ---------- -------- Total Loan Acquisitions .... $1,587,792 $546,895 ========== ======== Seventy percent of mortgage loans acquired by the long-term investment operations from the mortgage operations during the first six months of 2002 were six month ARMs as compared to 4% during the same period of 2001. The shift from acquiring primarily six month hybrids prior to the end of the third quarter of 2001 to primarily acquiring six month LIBOR indexed ARMs reflects a widening gap between short- and long-term interest rates and adjustable- and fixed-rate mortgages and borrowers belief that short-term interest rates will not increase significantly in the near term. The acquisition for long-term investment of a higher than expected volume of ARMs from the mortgage operations has shifted projected future earnings from a reliance on gain on sale of loans as a source of revenue to net interest income generated from the balance sheet. To finance the acquisition of mortgage loans during the first six months of 2002, the long-term investment operations issued $1.7 billion of CMOs, which were primarily AAA rated bonds, and were priced on a weighted average basis of one-month LIBOR plus 41 basis points. In addition, we raised net proceeds of approximately $57.0 million upon the issuance of 7.4 million shares of common stock and sold 489,300 shares of common stock under our sales agency agreement, which provided

net proceeds of approximately $5.5 million. During the first six months of 2002 and 2001, provision for loan losses was $7.9 million. Actual loan losses, net of recoveries, during the first six months of 2002 were $2.7 million as compared to $5.2 million during the same period of 2001. Equity in net earnings of IFC increased 110% to $10.1 million during the first six months of 2002 as compared to $4.8 million during the same period of 2001 as loan acquisitions and originations and sales volume rose. Loan acquisitions and originations during the first six months of 2002 was $2.6 billion as compared to $1.4 billion during the same period of 2001. The increase in loan production resulted in loan sales of $2.5 billion during the first six months of 2002 which contributed to gain on sale of loans of $35.7 million as compared to loan sales of $1.4 billion 26 which contributed to gain on sale of loans of $20.5 million during the first six months of 2001. Refer to "Results of Operations--Impac Funding Corporation" for more information on the operating results of IFC. Core Operating Earnings. Core operating earnings for the first six months of 2002 increased to $34.4 million, or $0.90 per diluted share, as compared to core operating earnings of $16.8 million, or $0.63 per diluted share, for the same period of 2001. Core operating earnings reflect recurring earnings from operations and exclude one-time, non-recurring income and expense items and the effect of fair market accounting for derivative instruments and hedging activities. Core operating earnings for the first six months of 2002 were higher than net earnings as core operating earnings exclude $1.0 million in write-down of investment securities available-for-sale. Core operating earnings is a concept not recognized by GAAP and may not be comparable to core operating earnings of other companies. The following table summarizes the calculation of core operating earnings and a reconciliation of core operating earnings to net earnings (in thousands, except earnings per share amounts): For the Six Months Ended June 30, ------------------ 2002 2001 ------- ------- Net earnings .... $33,374 $ 9,925 Adjustments to net earnings: Mark-to-market loss - FAS 133 .... -- 1,445 Write-down on investment securities available-for-sale .. 1,039 107 Extraordinary item .... -- 1,006 Cumulative effect of change in accounting principle ..... -- 4,313 ------- ------- Core operating earnings .... $34,413 $16,796 ======= ======= Core operating earnings per share .... $ 0.90 $ 0.63 ======= ======= Estimated Taxable Earnings. Estimated taxable earnings for the first six months of 2002 were $35.4 million, or $0.92 per diluted share, as compared to $18.9 million, or $0.71 per diluted share, during the same period of 2001. Estimated taxable earnings during the first six months of 2002 were greater than net earnings per GAAP as excess provision for loan losses cannot be deducted from taxable earnings. During the second quarter of 2002, provision for loan losses of $7.9 million were in excess of actual loan charge-offs, net of recoveries, of $2.7 million. In addition, estimated taxable earnings for the second quarter of 2002 reflects a $5.7 million dividend from IFC on its after-tax net earnings of $10.2 million. The board of directors declared cash dividends of $0.83 per share during the first six months of 2002. The following table summarizes the calculation of estimated taxable earnings and a reconciliation of estimated taxable earnings to net earnings (in thousands, except earnings per share amounts): For the Six Months Ended June 30, --------------------- 2002 2001 -------- -------- Net earnings .... $ 33,374 $ 9,925 Adjustments to net earnings: Mark-to-market loss - FAS 133 .... -- 1,445 Write-down on investment securities available-for-sale ..... 1,039 107 Cumulative effect of change in accounting principle .... -- 4,313 Loan loss provision .... 7,941 7,943 Dividends from IFC .... 5,693 4,419 Cash received from previously charged-off assets .... 649 827 Tax deduction for actual loan losses .... (2,699) (5,216) Equity in net earnings of IFC .... (10,062) (4,818) Tax difference of amortization of derivative instruments ... (505) -- -------- -------- Estimate taxable earnings (1) .... $ 35,430 $ 18,945 ======== ======== Estimated taxable earnings per share (1) .... $ 0.92 $ 0.71 ======== ======== 27 (2) Reflects calculation of estimated taxable earnings generated by the Company during periods shown. Excludes tax deductions of $5.4 million during the first six months of 2001 for amortization of the termination of the Company's management agreement in 1997, the deduction for dividends paid and the availability of a deduction attributable to a net operating loss carry forward. As of December 31, 2001, the Company's estimated federal net operating loss carry forwards were $21.5 million, which expire in the year 2020, and estimated state net operating loss carry forwards of $21.5 million, which expire in the year 2010, that are available to offset future taxable income. Results of Operations-- Impac Funding Corporation For the Six Months Ended June 30, 2002 as compared to the Six Months Ended June 30, 2001 Net earnings increased 108% to $10.2 million during the first six months of 2002 as compared to $4.9 million during the same period of 2001 as loan acquisitions and originations and sales volume rose. Net earnings during the first six months of 2002 included a gain of $1.7 million on the sale of 377,028 shares of IMH common stock which IFC acquired during 2001. The sale of IMH common stock

during the first six months of 2002 represented the remaining shares owned by IFC. Loan acquisitions and originations increased 86% to $2.6 billion during the first six months of 2002 as compared to $1.4 billion during the same period of 2001. Loan acquisitions and originations during the first six months of 2002 were driven by low mortgage rates, strong housing demand, innovative loan programs and IFC's automated underwriting system, IDASL, which enhances the origination process. The increase in loan acquisitions and originations resulted in loan sales of $2.5 billion during the first six months of 2002, which contributed to gain on sale of loans of $35.7 million as compared to loan sales of $1.4 billion which contributed gain on sale of loans of $20.5 million during the first six months of 2002. Additionally, profit margins on mortgage loans sold during the first six months of 2002 were more favorable as compared to profit margins on mortgage loans sold during the same period of 2001. The following table summarizes mortgage loan acquisitions and originations for the periods indicated (in thousands): LOAN PRODUCTION SUMMARY (excludes premiums paid) For the Six Months Ended June 30, ------------------------------------ 2002 2001 ---------------- ---------------- Balance % Balance % ------- - ------- - Volume by Type: Fixed rate .... $ 767,040 30 $ 833,750 61 Second trust deeds .... 37,686 1 19,796 2 Adjustable rate: Six month LIBOR ARMs .... 1,147,628 25,323 Six month LIBOR hybrids .... 619,450 483,168 --------- ---------- Total adjustable rate .... 1,767,078 69 508,491 37 --------- ---------- Total Loan Production .... $2,571,804 $1,362,037 ========== ========== Volume by Channel: Correspondent acquisitions .... $1,914,214 74 $1,060,469 78 Wholesale and retail originations ... 491,798 19 301,568 22 Novelle Financial Services .... 165,792 7 -- 0 ---------- ---------- Total Loan Production .... $2,571,804 $1,362,037 ========== Volume by Credit Quality: Alt-A loans .... $2,395,028 93 $1,352,595 99 B/C loans .... 176,776 7 9,442 1 ---------- Total Loan Production .... $2,571,804 $1,362,037 ========== ========== Volume by Purpose: Purchase .... $1,487,370 58 $ 841,236 62 Refinance .... 1,084,434 42 520,801 38 ---------- ---------- Total Loan Production .... $2,571,804 $1,362,037 ========== ========== Volume by Prepayment Penalty: With prepayment penalty .... $1,919,212 75 $ 891,706 65 Without prepayment penalty .... 652,592 25 470,331 35 ---------- ---------- Total Loan Production .... $2,571,804 $1,362,037 ========== ========== 28 Net interest income increased to $3.7 million during the first six months of 2002 as compared to $773,000 during the same period of 2001 as average loans held for sale increased and net interest margins widened. Average loans held for sale increased to $420.5 million during the first six months of 2002 as compared to $273.4 million during the same period of 2001 as a result of higher loan production. Net interest margins increased to 2.00% during the first six months of 2002 as compared to 0.83% during the same period of 2001 as interest rate spreads on FRMs and ARMs widened. Total non-interest expense increased to $23.2 million during the first six months of 2002 as compared to $14.7 million during the same period of 2001. The increase in total non-interest expense was primarily due to an increase in personnel expense as staff was added to meet greater loan acquisition and origination volumes. Although non-interest expense increased during the first six months of 2002, fully loaded expense to acquire and originate an Alt-A mortgage loan declined to 77 basis points during the first six months of 2002 as compared to 94 basis points during the first six months of 2001. Fully loaded expense includes both direct costs incurred to acquire and originate Alt-A mortgage loans, which includes loan origination and sales and marketing costs, and indirect costs, which includes accounting, administration, legal and information technology costs. Liquidity and Capital Resources We recognize the need to have funds available for our operating businesses and our customer's demands for obtaining short-term warehouse financing until the settlement or sale of mortgage loans with us or with other investors. It is our policy to have adequate liquidity at all times to cover normal cyclical swings in funding availability and loan demand and to allow us to meet abnormal and unexpected funding requirements. We plan to meet liquidity through normal operations with the goal of avoiding unplanned sales of assets or emergency borrowing of funds. Toward this goal, our asset and liability committee ("ALCO") is responsible for monitoring our liquidity position and funding needs. ALCO is comprised of the senior executives of the Company. ALCO meets on a weekly basis to review current and projected sources and uses of funds. ALCO monitors the composition of the balance sheet for changes in the liquidity of our assets in adverse market conditions. Our liquidity consists of cash and cash equivalents, short-term and marketable investment securities rated AAA through BBB and mortgage loans temporarily funded in cash and maturing mortgage loans, or "liquid assets." Our policy is to maintain a liquidity threshold of 5% of liquid assets to warehouse borrowings, reverse repurchase agreements, dividends payable and other short-term liabilities. During the second quarter of 2002, we were in compliance with this policy, which ALCO reports to the board of directors at least quarterly. As of June 30, 2002, overall liquidity was 9%. Sources of Liquidity

Our business operations are primarily funded as follows: o monthly interest and principal payments from our mortgage loan and investment securities portfolios; o CMO and reverse repurchase agreements secured by mortgage loans and mortgage-backed securities; o proceeds from securitization and whole loan sale of mortgage loans; and o cash from the issuance of securities. We use CMO borrowings and reverse repurchase agreements to fund substantially all of our mortgage loan and mortgage-backed securities portfolios. As we accumulate mortgage loans for long-term investment, we issue CMOs secured by the mortgage loans as a means of providing long-term financing and repaying short-term warehouse advances. The use of CMOs provides the following benefits: o allows us to lock in our financing cost over the life of the mortgage loans securing the CMO borrowings; and o eliminates margin calls on the borrowings that are converted from reverse repurchase agreements to CMO financing. 29 Terms of CMO borrowings require that an independent third party custodian hold mortgage loans as collateral. The maturity of each CMO bond class is directly affected by the rate of early principal payments on the related collateral. As of June 30, 2002, interest rates on adjustable rate CMOs can range from a low of 0.26% over one-month LIBOR on "AAA" credit rated bonds to a high of 3.60% over one-month LIBOR, or 2.10% to 4.24%. Interest rates on fixed rate CMOs range from 6.65% to 7.25% depending on the class of CMOs issued. Equity in the CMOs is established at the time CMOs are issued at levels sufficient to achieve desired credit ratings on the securities from rating agencies. We also determine the amount of equity invested in CMOs based upon the anticipated return on equity as compared to estimated proceeds from additional debt issuance. Total credit loss exposure is limited to the equity invested in the CMOs at any point in time. During the first six months of 2002, we issued $1.737 billion of CMOs, which included $1.647 billion of AAA rated bonds and $90.0 million of BBB rated bonds that were priced on a weighted average basis of one-month LIBOR plus 41 basis points, to provide long-term financing for $1.750 billion of mortgage loans securing CMOs. Because of the credit profile, historical loss performance and prepayment characteristics of our non-conforming Alt-A mortgages, we have been able to borrow a higher percentage against mortgage loans securing CMOs, which means that we have to provide less capital at the time mortgage loans are securitized. By decreasing the amount of capital we have to invest in our CMOs, we have been able to efficiently utilize our available capital. Before the issuance of CMOs, we finance the acquisition of mortgage loans primarily through borrowings on reverse repurchase agreements with third party lenders. When we have accumulated a sufficient amount of mortgage loans, we issue CMOs and convert short-term advances under reverse repurchase agreements to long-term CMO financing. Since 1995, we have had an uncommitted repurchase facility with a major investment bank to finance the acquisition of mortgage loans as needed. In order to give us more flexibility in our borrowing arrangements and to reduce our reliance on one lender, we entered into an additional uncommitted repurchase facility with an investment bank in June 2002. Terms of the reverse repurchase agreements require that mortgage loans be held by an independent third party custodian, which gives us the ability to borrow against a percentage of the outstanding principal balance of the mortgage loans. The borrowing rates vary from 85 basis points to 200 basis points over one-month LIBOR, depending on the type of collateral provided. The advance rates on the reverse repurchase agreements is based on the type of mortgage collateral provided and generally range from 70% to 98% of the fair market value of the collateral. The mortgage operations currently has warehouse line agreements with the warehouse lending operations to obtain financing of up to $850.0 million to provide interim mortgage loan financing during the period that the mortgage operations accumulates mortgage loans until the mortgage loans are securitized or sold. The margins on reverse repurchase agreements are based on the type of collateral provided by the mortgage operations and generally range from 95% to 99% of the fair market value of the collateral. The interest rates on the borrowings are indexed to prime minus 0.50%, which was 4.75% at June 30, 2002. We expect to continue to use short-term warehouse facilities to fund the acquisition of mortgage loans. If we cannot renew or replace maturing borrowings, we may have to sell, on a whole loan basis, the loans securing these facilities which, depending upon market conditions, may result in substantial losses. Additionally, if for any reason the market value of our mortgage loans securing warehouse facilities decline, our lenders may require us to provide them with additional equity or collateral to secure our borrowings, which may require us to sell mortgage loans at substantial losses. When the mortgage operations accumulates a sufficient amount of mortgage loans, it sells or securitizes mortgage loans. During the first six months of 2002, the mortgage operations securitized $594.7 million of mortgage loans as REMICs and sold $1.6 billion, in unpaid principal balance, of mortgage loans to the long-term investment operations. In addition, the mortgage operations sold $308.6 million, in unpaid principal balance, of mortgage loans to other investors. The mortgage operations sold mortgage servicing rights on all ARM and FRM securitizations completed during the second quarter of 2002. This

generated 100% cash gains on securitization and sale of mortgage loans. Cash from the sale of mortgage servicing rights was deployed in the mortgage operations and used to acquire and originate additional mortgage loans. In order to mitigate interest rate and market risk, we attempt to securitize our mortgage loans more frequently. Although securitizing mortgage loans more frequently adds operating and securitization costs, we believe the added cost is offset as less capital is required and more liquidity is provided with less interest rate and price volatility, as the 30 accumulation and holding period of mortgage loans is shortened. The mortgage operations currently has agreements in place for the sale of mortgage loans and mortgage servicing rights with an investment bank and large mortgage loan servicer, respectively. This allows the mortgage operations to forward price its REMIC and CMO transactions on a servicing released basis and achieve greater stability in the execution of its securitizations. On December 1, 2001, we filed a registration statement with the SEC, which allows us to sell up to $300.0 million of securities, including common stock, preferred stock, debt securities and warrants. This type of registration statement is commonly referred to as a "shelf" registration process. In conjunction with the filing of the shelf, we completed the sale of 7,402,000 shares of common stock during the first quarter of 2002, which provided net proceeds of approximately $57.0 million. On May 22, 2002, we entered into a sales agency agreement with UBS Warburg LLC ("the Agent") to sell up to 3,594,082 shares of common stock. In conjunction with the sales agency agreement, we completed the sale of 489,300 shares of common stock during the three months ended June 30, 2002, which provided net proceeds of approximately $5,485,692. The Agent received an aggregate of $169,666 which is from a commission of 3% based on the gross sales price per share of the shares sold under the sales agency agreement. Uses of Liquidity Our business operations primarily use funds as follows: o acquisition and origination of mortgage loans; o provide short-term warehouse financing; and o pay common stock dividends. During the first six months of 2002, we acquired and originated $2.6 billion of mortgage loans of which we retained $1.6 billion for long-term investment. The acquisition and origination of mortgage loans by the mortgage operations during the second quarter of 2002 resulted in premium costs of 1.53% of the outstanding principal balance of mortgage loans. Our equity investment in mortgage loans is outstanding until we sell or securitize our mortgage loans, which is one of the reasons we attempt to securitize our mortgage loans frequently. When we complete CMOs our required equity investment generally ranges from approximately two and one-half percent to 5% of the outstanding principal balance of mortgage loans, depending on our premium costs, securitization costs, interest rate hedge acquisition costs and the capital investment required. Since we rely significantly upon securitizations to generate cash proceeds to repay borrowings and to create credit availability, any disruption in our ability to complete securitizations may require us to utilize other sources of financing, which, if available at all, may be on unfavorable terms. In addition, delays in closing securitizations of our mortgage loans increase our risk by exposing us to credit and interest rate risks for this extended period of time. Furthermore, gains on sales from our securitizations represent a significant portion of our earnings. We utilize our uncommitted warehouse lines to provide short-term warehouse financing to affiliates and external customers of the warehouse lending operations. The mortgage operations has a $850.0 million warehouse facility with the warehouse lending operations to fund the acquisition and origination of mortgage loans until sale or securitization. The warehouse lending operations provides financing to affiliates at prime minus 0.50%. As of June 30, 2002, affiliates had $238.4 million outstanding on the warehouse line with the warehouse lending operations. The warehouse lending operations provides financing to non-affiliates at prime plus a spread. Non-affiliates can generally finance between 95% and 98% of the fair market value of the mortgage loans. As of June 30, 2002, the warehouse lending operations had $498.0 million of approved warehouse lines available to its non-affiliate customers of which $343.4 million was outstanding. Our ability to meet liquidity requirements and the financing need of our customers is subject to the renewal of our credit and repurchase facilities or obtaining other sources of financing, if required, including additional debt or equity from time to time. Any decision our lenders or investors make to provide available financing to us in the future will depend upon a number of factors, including: o our compliance with the terms of our existing credit arrangements; o our financial performance; o industry and market trends in our various businesses; o the general availability of and rates applicable to financing and investments; o our lenders or investors resources and policies concerning loans and investments; and 31 o the relative attractiveness of alternative investment or lending opportunities. During the first quarter of 2002, we declared a common stock dividend of $0.40 per common share, or $15.8 million, which was paid on April 16, 2002. During the second quarter of 2002, we declared a common stock dividend of $0.43 per common share, or $17.2 million, which was paid on July 12, 2002. Cash Flows Operating Activities - During the first six months of 2002, net cash used in operating activities was $89.6 million mainly due to net change in other assets and liabilities of $132.9

million. An entry to accounts receivable for $132.5 million was recorded for the pre-funding of the CMO that was completed on June 26, 2002 Investing Activities - During the first six months of 2002, net cash used in investing activities was $1.3 billion. Net cash flows of $1.2 billion, including principal repayments, was used in investing activities to acquire and originate mortgage loans and $102.7 million was used to provide short-term advances warehouse advances to affiliates and external customers. Financing Activities - During the first six months of 2002, net cash provided by financing activities was $1.4 billion. Net cash flows of $1.3 billion was provided by proceeds from CMO borrowings net of repayment of CMO borrowings, $43.3 million was provided by advances on warehouse lines and $62.5 million was provided by the issuance of common stock. Inflation The consolidated financial statements and corresponding notes to the consolidated financial statements have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased costs of our operations. Unlike industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Inflation affects our operations primarily through its effect on interest rates, since interest rates normally increase during periods of high inflation and decrease during periods of low inflation. During periods of increasing interest rates, demand for mortgage loans and a borrower's ability to qualify for mortgage financing in a purchase transaction may be adversely affected. During periods of decreasing interest rates, borrowers may prepay their mortgages, which in turn may adversely affect our yield and subsequently the value of our portfolio of mortgage assets. Risk Factors A prolonged economic downturn or recession would likely result in a reduction of our mortgage origination activity which would adversely affect our financial results. An economic downturn or a recession may have a significant adverse impact on our operations and our financial condition. For example, a reduction in new mortgages will adversely affect our ability to expand our mortgage portfolio, our principal means of increasing our earnings. In addition, a decline in new mortgage activity will likely result in reduced activity for our warehouse lending operations and our long-term investment operations. In the case of our mortgage operations, a decline in mortgage activity may result in fewer loans that meet its criteria for purchase and securitization, thus resulting in a reduction in interest income and fees and gain on sale of loans. We may also experience larger than previously reported losses on our investment portfolio due to a higher level of defaults on our mortgage loans. If we are unable to generate sufficient liquidity we will be unable to conduct our operations as planned If we cannot generate sufficient liquidity, we will be unable to continue to grow our operations, grow our asset base, maintain our current hedging policy and pay dividends. We have traditionally derived our liquidity from four primary sources: o financing facilities provided to us by others to acquire or originate mortgage assets; 32 o whole loan sales and securitizations of acquired or originated mortgage loans; o our issuance of equity and debt securities; and o earnings from operations. We cannot assure you that any of these alternatives will be available to us, or if available, that we will be able to negotiate favorable terms. Our ability to meet our long-term liquidity requirements is subject to the renewal of our credit and repurchase facilities and/or obtaining other sources of financing, including additional debt or equity from time to time. Any decision by our lenders and/or investors to make additional funds available to us in the future will depend upon a number of factors, such as our compliance with the terms of our existing credit arrangements, our financial performance, industry and market trends in our various businesses, the lenders' and/or investors' own resources and policies concerning loans and investments, and the relative attractiveness of alternative investment or lending opportunities. If we cannot raise cash by selling debt or equity securities, we may be forced to sell our assets at unfavorable prices or discontinue various business activities. Our inability to access the capital markets could have a negative impact on our earnings and hence, our ability to pay dividends. Any significant margin calls under our financing facilities would adversely affect our liquidity and may adversely affect our financial results Prior to the fourth quarter of 1998, we generally had no difficulty in obtaining favorable financing facilities or in selling acquired mortgage loans. However, during the fourth quarter of 1998, the mortgage industry experienced substantial turmoil as a result of a lack of liquidity in the secondary markets. At that time, investors expressed unwillingness to purchase interests in securitizations due, in part, to: o the lack of financing to acquire these securitization interests; o the widening of returns expected by institutional investors on securitization interests over the prevailing Treasury rate; and o market uncertainty. As a result, many mortgage loan originators, including our company, were unable to access the securitization market on favorable terms. This resulted in some companies declaring bankruptcy. Originators, like our company, were required to sell loans on a whole loan basis and liquidate holdings of mortgage-backed securities

to repay short-term borrowings. However, the large amount of loans available for sale on a whole loan basis affected the pricing offered for these loans, which in turn reduced the value of the collateral underlying the financing facilities. Therefore, many providers of financing facilities initiated margin calls. Margin calls resulted when our lenders evaluated the market value of the collateral securing our financing facilities and required us to provide them with additional equity or collateral to secure our borrowings. Our financing facilities were short-term borrowings and due to the turmoil in the mortgage industry during the latter part of 1998 many traditional providers of financing facilities were unwilling to provide facilities on favorable terms, or at all. Our current financing facilities continue to be short-term borrowings and we expect this to continue. If we cannot renew or replace maturing borrowings, we may have to sell, on a whole loan basis, the loans securing these facilities which, depending upon market conditions, may result in substantial losses. We incurred losses for fiscal years 1997, 1998 and 2000 and may incur losses in the future During the year ended December 31, 2000, we experienced a net loss of $54.2 million. The net loss incurred during 2000 included non-cash accounting charges of $68.9 million. The non-cash accounting charges were the result of write-downs of non-performing investment securities secured by mortgages and additional increases in allowance for loan losses to provide for the deteriorating performance of collateral supporting specific investment securities. During the year ended December 31, 1998, we experienced a net loss of $5.9 million. During the year ended December 31, 1997, we experienced a net loss of $16.0 million. The net loss incurred during 1997 included a non-cash accounting charge of $44.4 million that was the result of expenses related to the termination and buyout of our management agreement with Imperial Credit Advisors, Inc. We cannot be certain that revenues will remain at current levels or improve or that we will be profitable in the future, which could prevent us from effectuating our business strategy. If we are unable to complete securitizations, we would face a liquidity shortage which would adversely affect our operating results. 33 We rely significantly upon securitizations to generate cash proceeds to repay borrowings and to create credit availability. Any reduction in our ability to complete securitizations may require us to utilize other sources of financing, which, if available at all, may be on unfavorable terms. In addition, delays in closing securitizations of our mortgage loans increase our risk by exposing our company to credit and interest rate risks for this extended period of time. Furthermore, gains on sales from our securitizations represent a significant portion of our earnings. Several factors could affect our ability to complete securitizations of our mortgages, including: o conditions in the securities and secondary markets; o credit quality of the mortgage loans acquired or originated through our mortgage operations; o volume of our mortgage loan acquisitions and originations; o our ability to obtain credit enhancements; and o lack of investors purchasing higher risk components of the securities. If we are unable to profitably securitize a significant number of our mortgage loans in a particular financial reporting period, then we could experience lower income or a loss for that period. As a result of turmoil in the securitization market during the latter part of 1998, many mortgage lenders, including our company, were required to sell mortgage loans on a whole loan basis under adverse market conditions in order to generate liquidity. Many of these sales were made at prices lower than our carrying value of the mortgage loans and we experienced substantial losses. We cannot assure you that we will be able to continue to profitably securitize or sell our loans on a whole loan basis, or at all. The market for first loss risk securities, which are securities that take the first loss when mortgages are not paid by the borrowers, is generally limited. In connection with our REMIC securitizations, we endeavor to sell all securities subjecting us to a first loss risk. If we cannot sell these securities, we may be required to hold them for an extended period, subjecting us to a first loss risk. Our borrowings and use of substantial leverage may cause losses Our use of collateralized mortgage obligations may expose our operations to credit losses To grow our investment portfolio, we borrow a substantial portion of the market value of substantially all of our investments in mortgage loans in the form of CMOs. Historically, we have borrowed approximately 98% of the market value of such investments. There are no limitations on the amount we may borrow, other than the aggregate value of the underlying mortgage loans. We currently use CMOs as financing vehicles to increase our leverage, since mortgage loans held for CMO collateral are retained for investment rather than sold in a secondary market transaction. Retaining mortgage loans as collateral for CMOs exposes our operations to greater credit losses than does the use of other securitization techniques that are treated as sales because as the equity holder in the security, we are allocated losses from the liquidation of defaulted loans first prior to any other security holder. Although our liability under a collateralized mortgage obligation is limited to the collateral used to create the collateralized mortgage obligation, we generally are required to make a cash equity investment to fund collateral in excess of the amount of the securities issued in order to obtain the appropriate credit ratings for the securities being sold, and therefore obtain the lowest interest rate available, on the CMOs. If we

experience greater credit losses than expected on the pool of loans subject to the CMO, the value of our equity investment will decrease and we would have to increase the allowance for loan losses on our financial statements. The cost of our borrowings may exceed the return on our assets The cost of borrowings under our financing facilities corresponds to a referenced interest rate plus or minus a margin. The margin varies depending on factors such as the nature and liquidity of the underlying collateral and the availability of financing in the market. We will experience net interest losses if the returns on our assets financed with borrowed funds fail to cover the cost of our borrowings, and we did not implement any applicable financial hedges. If we default under our financing facilities, we may be forced to liquidate the collateral at prices less than the amount borrowed 34 If we default under our financing facilities, our lenders could force us to liquidate the collateral. If the value of the collateral is less than the amount borrowed, we could be required to pay the difference in cash. If we were to declare bankruptcy, some of our reverse repurchase agreements may obtain special treatment and our creditors would then be allowed to liquidate the collateral without any delay. On the other hand, if a lender with whom we have a reverse repurchase agreement declares bankruptcy, we might experience difficulty repurchasing our collateral, or enforcing our claim for damages, and it is possible that our claim could be repudiated and we could be treated as an unsecured creditor. If this occurs, our claims would be subject to significant delay and we may receive substantially less than our actual damages or nothing at all. If we are forced to liquidate we may have few unpledged assets for distribution to unsecured creditors We have pledged a substantial portion of our assets to secure the repayment of CMOs issued in securitizations, our financing facilities and our other borrowings. We will also pledge substantially all of our current and future mortgage loans to secure borrowings pending their securitization or sale. The cash flows we receive from our investments that have not yet been distributed, pledged or used to acquire mortgage loans or other investments may be the only unpledged assets available to our unsecured creditors and you if our company was liquidated. Interest rate fluctuations may adversely affect our operating results Our operations, as a mortgage loan acquirer and originator or a warehouse lender, may be adversely affected by rising and falling interest rates. Higher interest rates may discourage potential borrowers from refinancing mortgages, borrowing to purchase homes or seeking second mortgages. This may decrease the amount of mortgages available to be acquired or originated by our mortgage operations and decrease the demand for warehouse financing provided by our warehouse lending operations. If short-term interest rates exceed long-term interest rates, there is a higher risk of increased loan prepayments, as borrowers may seek to refinance their fixed and adjustable rate mortgage loans at lower long-term fixed interest rates. Increased loan prepayments could lead to a reduction in the number of loans in our investment portfolio and reduce our net interest income. We are subject to the risk of rising mortgage interest rates between the time we commit to purchase mortgages at a fixed price through the issuance of individual, bulk or other rate-locks and the time we sell or securitize those mortgages. An increase in interest rates will generally result in a decrease in the market value of mortgages that we have committed to purchase at a fixed price, but have not been sold or securitized or have not been properly hedged. As a result, we may record a smaller gain, or even a loss, upon the sale or securitization of those mortgage loans. We may experience losses if our liabilities re-price at different rates than our assets Our principal source of revenue is net interest income or net interest spread from our investment portfolio, which is the difference between the interest we earn on our interest earning assets and the interest we pay on our interest bearing liabilities. The rates we pay on our borrowings are independent of the rates we earn on our assets and may be subject to more frequent periodic rate adjustments. Therefore, we could experience a decrease in net interest income or a net interest loss because the interest rates on our borrowings could increase faster than the interest rates on our assets. If our net interest spread becomes negative, we will be paying more interest on our borrowings than we will be earning on our assets and we will be exposed to a risk of loss. Additionally, the rates paid on our borrowings and the rates received on our assets may be based upon different indices. If the index used to determine the rate on our borrowings, typically one-month LIBOR, increases faster than the indices used to determine the rates on our assets, such as six-month LIBOR, one-year CMT, or the prime rate, we will experience a declining net interest spread, which will have a negative effect on our profitability, and may result in losses. An increase in our adjustable interest rate borrowings may decrease the net interest margin on our adjustable rate mortgages Our long-term investment portfolio includes mortgage loans that are hybrids ARMs. These are mortgages with fixed interest rates for an initial period of time, after which they begin bearing interest based upon short-term interest rate indices. We generally fund mortgages with adjustable interest rate borrowings having interest rates that are indexed to short-term interest rates and adjust periodically at various intervals. To the extent that there is an increase in the interest rate index used to determine our adjustable interest rate borrowings and that increase is not

offset by a 35 corresponding increase in the rates at which interest accrues on our assets or by various interest rate hedges that we have in place at any given time, our net interest margin will decrease or become negative. We may suffer a net interest loss on our adjustable rate mortgages that have interest rate caps if the interest rates on our related borrowings increase Adjustable rate mortgages typically have interest rate caps, which limit interest rates charged to the borrower during any given period. Our borrowings are not subject to similar restrictions. As a result, in a period of rapidly increasing interest rates, the interest rates we pay on our borrowings could increase without limitation, while the interest rates we earn on our adjustable rate mortgage assets would be capped. If this occurs, our net interest spread could be significantly reduced or we could suffer a net interest loss. Increased levels of prepayments of our adjustable rate mortgage loans may accelerate our expenses and decrease our net income Mortgage prepayments generally increase on our adjustable rate mortgages when fixed mortgage interest rates fall below the then-current interest rates on outstanding adjustable rate mortgage loans. Prepayments on mortgage loans are also affected by the terms and credit grades of the loans, conditions in the housing and financial markets and general economic conditions. Most of the adjustable rate mortgages that we acquire are originated within three months of the time we purchased the mortgages and generally bear initial interest rates that are lower than their fully-indexed amount (the applicable index plus the margin). If we acquire these mortgages at a premium and they are repaid prior to or soon after the time of adjustment to a fully-indexed rate without payment of any prepay penalty, we would not have received interest at the fully-indexed rate during such period and we must expense the unamortized premium that was paid for the loan at the time of the prepayment. This means we would lose the opportunity to earn interest at that rate over the expected life of the mortgage. Also, if prepayments on our adjustable rate mortgage loans increase when interest rates are declining, our net interest income may decrease if we cannot reinvest the prepayments in mortgage assets bearing comparable rates. Prepayments on fixed rate mortgages will also decrease our net interest income when interest rates are declining. We generally acquire mortgages on a servicing released basis, meaning we acquire both the mortgages and the rights to service them. This strategy requires us to pay a higher purchase price or premium for the mortgages. If the mortgage loans that we acquire at a premium prepay faster than originally projected, generally accepted accounting principles require us to write down the remaining capitalized premium amounts at a faster speed than was originally projected, which would decrease our current net interest income. The value of our portfolio of mortgage-backed securities may be adversely affected by unforeseen events Our prior investments in residual interest and subordinated debt investments exposed us to greater risks as compared to those associated with senior mortgage-backed securities Prior to 1998, we invested in mortgage-backed securities known as interest-only, principal-only, residual interest or other subordinated securities. Investments in residual interest and subordinated securities are much riskier than investments in senior mortgage-backed securities because these subordinated securities bear all credit losses prior to the related senior securities. The risk associated with holding residual interest and subordinated securities is greater than that associated with holding the underlying mortgage loans directly due to the concentration of losses attributed to the subordinated securities. If the projected value of our portfolio of residual interest and subordinated debt instruments is incorrect we would have to write down the value of these securities We estimate future cash flows from these securities and value them utilizing assumptions based in part on projected discount rates, mortgage loan prepayments and credit losses. If our actual experience differs from our assumptions, we would be required to reduce the value of these securities. The market for our asset-backed securities is extremely limited and we cannot assure you that we could sell these securities at their reported value, or at any value or that we could recoup our initial investment. In addition, we may not obtain our anticipated yield or we may incur losses if the credit support available within certain mortgage-backed securities is inadequate due to unanticipated levels of losses, or due to difficulties experienced by the credit support provider. Delays or difficulties encountered in servicing the mortgages in mortgage-36 backed securities may cause greater losses and, therefore, greater resort to credit support than was originally anticipated, and may cause a rating agency to downgrade certain classes of our mortgage-backed securities, which might then equate to a reduction of the value of the security. We undertake additional risks by acquiring and investing in mortgage loans We may be subject to losses on mortgage loans for which we do not obtain credit enhancements We do not obtain credit enhancements such as mortgage pool or special hazard insurance for all of our mortgage loans and investments. Generally, we require mortgage insurance on any loan with a loan-to-value ratio greater than 80%. During the time we hold mortgage loans for investment, we are subject to risks of borrower defaults and bankruptcies and special hazard losses that are not covered by standard hazard insurance. If a borrower defaults on a mortgage loan that we hold, we bear the risk of loss of principal to the extent there is any deficiency between the value of the related

mortgaged property and the amount owing on the mortgage loan and any insurance proceeds available to us through the mortgage insurer. In addition, since defaulted mortgage loans, which under our financing arrangements are mortgage loans that are generally 60 to 90 days delinquent in payments, may be considered negligible collateral under our borrowing arrangements, we could bear the risk of being required to own these loans without the use of borrowed funds until they are ultimately liquidated or possibly sold at a loss. Non-conforming Alt-A mortgage loans expose us to greater credit risks We are an acquirer and originator of non-conforming Alt-A residential mortgage loans. These are residential mortgages that do not qualify for purchase by government sponsored agencies such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Our operations may be negatively affected due to our investments in non-conforming Alt-A mortgage loans. Credit risks associated with non-conforming Alt-A mortgage loans are greater than those associated with conforming mortgage loans. The interest rates we charge on non-conforming Alt-A loans are often higher than those charged for conforming loans in order to compensate for the higher risk and lower liquidity. Lower levels of liquidity may cause us to hold loans or other mortgage-related assets supported by these loans that we otherwise would not hold. By doing this, we assume the potential risk of increased delinquency rates and/or credit losses as well as interest rate risk. Additionally, the combination of different underwriting criteria and higher rates of interest leads to greater risk, including higher prepayment rates and higher delinquency rates and/or credit losses. Lending to non-conforming Alt-A borrowers may expose us to a higher risk of delinquencies, foreclosures and losses As a lender of non-conforming Alt-A mortgage loans, our market includes borrowers who may be unable to obtain mortgage financing from conventional mortgage sources. Loans made to such non-conforming Alt-A borrowers generally entail a higher risk of delinquency and higher losses than loans made to borrowers who utilize conventional mortgage sources. Delinquency, foreclosures and losses generally increase during economic slowdowns or recessions. The actual risk of delinquencies, foreclosures and losses on loans made to non-conforming Alt-A borrowers could be higher under adverse economic conditions than those currently experienced in the mortgage lending industry in general. Further, any material decline in real estate values increases the loan-to-value ratios of loans previously made by us, thereby weakening collateral coverage and increasing the possibility of a loss in the event of a borrower default. Any sustained period of increased delinquencies, foreclosures or losses after the loans are sold could adversely affect the pricing of our future loan sales and our ability to sell or securitize our loans in the future. In the past, certain of these factors have caused revenues and net income of many participants in the mortgage industry, including us, to fluctuate from quarter to quarter. Our use of second mortgages exposes us to greater credit risks Our security interest in the property securing second mortgages is subordinated to the interest of the first mortgage holder and the second mortgages have a higher combined loan-to-value ratio than does the first mortgage. If the value of the property is equal to or less than the amount needed to repay the borrower's obligation to the first mortgage holder upon foreclosure, our second mortgage loan will not be repaid. The geographic concentration of our mortgage loans increases our exposure to risks in those areas 37 We do not set limitations on the percentage of our mortgage asset portfolio composed of properties located in any one area (whether by state, zip code or other geographic measure). Concentration in any one area increases our exposure to the economic and natural hazard risks associated with that area. For instance, certain parts of California have experienced an economic downturn in past years and California and Florida have suffered the effects of certain natural hazards. Representations and warranties made by us in our loan sales and securitizations may subject us to liability In connection with our securitizations, we transfer loans acquired or originated by us into a trust in exchange for cash and, in the case of a CMO, residual certificates issued by the trust. The trustee will have recourse to us with respect to the breach of the standard representations and warranties made by us at the time such loans are transferred. While we generally have recourse to our customers for any such breaches, there can be no assurance of our customers' abilities to honor their respective obligations. Also, we engage in bulk whole loan sales pursuant to agreements that generally provide for recourse by the purchaser against us in the event of a breach of one of our representations or warranties, any fraud or misrepresentation during the mortgage loan origination process, or upon early default on such mortgage loan. We generally limit the potential remedies of such purchasers to the potential remedies we receive from the people from whom we acquired or originated the mortgage loans. However, in some cases, the remedies available to a purchaser of mortgage loans from us may be broader than those available to us against the sellers of the loans and should a purchaser enforce its remedies against us, we may not always be able to enforce whatever remedies we have against our customers. In the ordinary course of our business, we are subject to claims made against us by borrowers and trustees in our securitizations arising from, among other things, losses that are claimed to have been incurred as a

result of alleged breaches of fiduciary obligations, misrepresentations, errors and omissions of our employees, officers and agents (including our appraisers), incomplete documentation and our failure to comply with various laws and regulations applicable to our business. Any claims asserted against us may result in legal expenses or liabilities that could have a material adverse effect on our results of operations or financial condition. We face conflicts of interests based on the ownership of the voting stock of Impac Funding Corporation by certain officers and directors of Impac Mortgage Holdings, Inc. We are subject to conflicts of interest arising from our relationship with Impac Mortgage Holdings, Inc., our long-term investment operations, Impac Funding Corporation, our mortgage operations, and their officers and directors. Our long-term investment operations acquires non-confirming Alt-A mortgage loans from our mortgage operations. Impac Mortgage Holdings, Inc. owns all of the preferred stock, and 99% of the economic interest in, Impac Funding Corporation. Joseph R. Tomkinson, our Chairman and Chief Executive Officer, William S. Ashmore, our Chief Operating Officer, President and a director, and Richard J. Johnson, our Executive Vice President and Chief Financial Officer, are holders of all of the outstanding voting stock of, and 1% of the economic interest in, Impac Funding Corporation. They have the right to elect all directors of Impac Funding Corporation and the ability to control the outcome of all matters for which the consent of the holders of the common stock of Impac Funding Corporation is required. Messer's Tomkinson, Ashmore and Johnson are also the sole directors of Impac Funding Corporation. Decisions made by these officers at one company may be at conflict with and have an adverse affect on the operations of the other. A substantial interruption in our use of IDASL may adversely affect our level of mortgage loan acquisitions and originations We utilize the Internet in our business principally for the implementation of our automated loan origination program, IDASL, which stands for Impac Direct Access System for Lending. IDASL is not a lead generator for mortgage brokers. IDASL allows our customers to pre-qualify borrowers for various loan programs based on criteria requested from the borrower and renders an automated underwriting decision by issuing an approval of the mortgage loan or a referral for further review or additional information. All of our correspondents submit loans through IDASL and all wholesale loans delivered by mortgage brokers are directly underwritten through IDASL. IDASL may be interrupted if the Internet experiences periods of poor performance, if our computer systems or the systems of our third-party service providers contain defects, or if customers are reluctant to use or have inadequate connectivity to the Internet. Increased government regulation of the Internet could also adversely affect our use of the Internet in unanticipated ways and discourage our customers from using our services. If our ability to use the Internet in providing our services is impaired, our ability to originate or acquire loans on an automated basis could be delayed or 38 reduced. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period. We are subject to risks of operational failure that are beyond our control Substantially all of our operations are located in Newport Beach, California. Our systems and operations are vulnerable to damage and interruption from fire, flood, telecommunications failure, break-ins, earthquake and similar events. Our operations may also be interrupted by power disruptions, including rolling black-outs implemented in California due to the state's continuing acute power shortage. We do not maintain alternative power sources. Furthermore, our security mechanisms may be inadequate to prevent security breaches to our computer systems, including from computer viruses, electronic break-ins and similar disruptions. Such security breaches or operational failures could expose us to liability, impair our operations, result in losses, and harm our reputation. Our reliance on third-party software for the implementation of IDASL exposes us to risks We have a licensing agreement with a third-party vendor for the use of hardware and software for IDASL. All of our correspondents are submitting loans through IDASL and all of our wholesale loans delivered by mortgage brokers are directly underwritten through the use of IDASL. The termination or impairment of this license could result in delays and reductions in the acquisition and origination of mortgage loans until equivalent hardware and software could be licensed and integrated, if at all possible, which may harm our business. In addition, we would be harmed if the provider from whom we license software ceases to deliver and support reliable products, enhance their current products or respond to emerging industry standards. If the hardware or software provided by our vendor fails for any reason, and the back-up hardware and software is not implemented in a timely manner, it may also delay and reduce those mortgage loan acquisitions and originations done through IDASL. The third-party hardware and software also may not continue to be available to us on commercially reasonable terms or at all. Any substantial delay and reduction in our mortgage loan acquisitions and originations will reduce our net earnings for the applicable period. Competition for mortgage loans is intense and may adversely affect our operations We compete in acquiring and originating non-conforming Alt-A mortgage loans and issuing mortgage-backed securities with: o other mortgage conduit programs; o investment banking firms; o

savings and loan associations; o banks; o thrift and loan associations; o finance companies; o mortgage bankers; o insurance companies; o other lenders; and o other entities purchasing mortgage assets. Some of our competitors are larger and have greater resources than we do. Consolidation in the mortgage banking industry may adversely affect us by reducing the number of current customers of our mortgage operations and our potential customer base. As a result, we may have to purchase a larger percentage of mortgage loans from a smaller number of customers, which may reduce our profit margins, or increase the cost to acquire these types of loans. We are exposed to potential credit losses in providing warehouse financing As a warehouse lender, we lend money to mortgage bankers on a secured basis and we are subject to the risks associated with lending to mortgage banks, including the risks of fraud, borrower default and bankruptcy, any of which could result in credit losses for us. Our claims as a secured lender in a bankruptcy proceeding may be subject to adjustment and delay. We may not pay dividends to stockholders 39 REIT provisions of the Internal Revenue Code generally require that we distribute to our stockholders at least 90% of all of our taxable income. These provisions restrict our ability to retain earnings and thereby renew capital for our business activities. We may decide at a future date to terminate our REIT status, which would cause us to be taxed at the corporate level, and cease paying regular dividends. In addition, for any year that we do not generate taxable income, we are not required to declare and pay dividends to maintain our REIT status. For instance, due to losses incurred in 2000, we did not declare any dividends from September 2000 until September 2001. To date, a portion of our taxable income and cash flow has been attributable to our receipt of dividend distributions from Impac Funding Corporation, our mortgage operations affiliate. Impac Funding Corporation is not a REIT and is not, therefore, subject to the above-described REIT distribution requirements. Because Impac Funding Corporation is seeking to retain earnings to fund the future growth of our mortgage operations business, its board may decide that Impac Funding Corporation should cease making dividend distributions in the future. This would materially reduce the amount of our taxable income and in turn, would reduce the amount we would be required to distribute as dividends. If we fail to maintain our REIT status, we may be subject to taxation as a regular corporation We believe that we have operated and intend to continue to operate in a manner that enables us to meet the requirements for qualification as a REIT for federal income tax purposes. We have not requested, and do not plan to request, a ruling from the Internal Revenue Service that we qualify as a REIT. Moreover, no assurance can be given that legislation, new regulations, administrative interpretations or court decisions will not significantly change the tax laws with respect to qualification as a REIT or the federal income tax consequences of such qualification. Our continued qualification as a REIT will depend on our satisfaction of certain asset, income, organizational and stockholder ownership requirements on a continuing basis. If we fail to qualify as a REIT, we would not be allowed a deduction for distributions to stockholders in computing our taxable income and would be subject to federal income tax at regular corporate rates. We also may be subject to the federal alternative minimum tax. Unless we are entitled to relief under specific statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year during which we were disqualified. Therefore, if we lose our REIT status, the funds available for distribution to you would be reduced substantially for each of the years involved. Failure to qualify as a REIT could adversely affect the value of our common stock. Delayed mortgage loan sales or securitization closings could have a material adverse affect on our operations A delay in closing a particular mortgage loan sale or securitization would increase our exposure to interest rate fluctuations by lengthening the period during which our variable rate borrowings under our warehouse facilities are outstanding. If we were unable to sell a sufficient number of mortgage loans at a premium during a particular reporting period, our revenues for that period would decline, which could have a material adverse affect on our operations. Our share prices have been and may continue to be volatile Historically, the market price of our common stock has been volatile. The market price of our common stock is likely to continue to be highly volatile and could be significantly affected by factors including: o the amount of dividends paid; o availability of liquidity in the securitization market; o loan sale pricing; o calls by warehouse lenders or changes in warehouse lending rates; o unanticipated fluctuations in our operating results; o prepayments on mortgages; o valuations of securitization related assets; o cost of funds; and o general market conditions. 40 In addition, significant price and volume fluctuations in the stock market have particularly affected the market prices for the common stock of mortgage REIT companies such as ours. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. If our results of operations fail to meet the expectations of securities analysts or investors in a future quarter, the market price of our common stock could also be materially adversely affected and we may experience difficulty in raising capital. If actual prepayments or defaults with respect to mortgage loans serviced occurs more quickly than originally assumed,

the value of our mortgage servicing rights would be subject to downward adjustment When we purchase loans that include the associated servicing rights, the allocated cost of the servicing rights is reflected on our financial statements as mortgage servicing rights. To determine the fair value of these servicing rights, we use assumptions to estimate future net servicing income including projected discount rates, mortgage loan prepayments and credit losses. If actual prepayments or defaults with respect to loans serviced occur more quickly than we originally assumed, we would have to reduce the carrying value of our mortgage servicing rights. We do not know if our assumptions will prove correct. Our operating results may be adversely affected by the results of our hedging activities To offset the risks associated with our mortgage operations, we enter into transactions designed to hedge our interest rate risks. To offset the risks associated with our long-term investment operations, we attempt to match the interest rate sensitivities of our adjustable rate mortgage assets held for investment with the associated financing liabilities. Our management determines the nature and quantity of the hedging transactions based on various factors, including market conditions and the expected volume of mortgage loan purchases. We do not limit management's use of certain instruments in such hedging transactions. While we believe that we properly hedge our interest rate risk, we may not, and in some cases will not, be permitted to use hedge accounting as established by FASB under the provisions of SFAS 133 to account for our hedging activities. The effect of our hedging strategy may result in some volatility in our quarterly earnings as interest rates go up or down. While we believe we properly hedge our interest rate risk, we cannot assure you that our hedging transactions will offset the risk of adverse changes in net interest margins. A reduction in the demand for residential mortgage loans and our non-conforming Alt-A loan products may adversely affect our operations The availability of sufficient mortgage loans meeting our criteria is dependent in part upon the size and level of activity in the residential real estate lending market and, in particular, the demand for non-conforming Alt-A mortgage loans, which is affected by: o interest rates; o national economic conditions; o residential property values; and o regulatory and tax developments. o If our mortgage loan purchases decrease, we will have: o decreased economies of scale; o higher origination costs per loan; o reduced fee income; o smaller gains on the sale of non-conforming mortgage loans; and o an insufficient volume of loans to generate securitizations which thereby causes us to accumulate loans over a longer period. Our delinquency ratios and our performance may be adversely affected by the performance of parties who sub-service our loans We contract with third-party sub-servicers for the sub-servicing of all the loans in which we retain servicing rights, including those in our securitizations. Our operations are subject to risks associated with inadequate or untimely servicing. Poor performance by a sub-servicer may result in greater than expected delinquencies and losses on our loans. A substantial increase in our delinquency or foreclosure rate could adversely affect our ability to access the capital and secondary markets for our financing needs. Also, with respect to loans subject to a securitization, greater 41 delinquencies would adversely impact the value of any interest-only, principal-only and subordinated securities we hold in connection with that securitization. In a securitization, relevant agreements permit us to be terminated as servicer or master servicer under specific conditions described in these agreements, such as the failure of a sub-servicer to perform certain functions within specific time periods. If, as a result of a sub-servicer's failure to perform adequately, we were terminated as servicer of a securitization, the value of any servicing rights held by us would be adversely affected. Potential characterization of distributions or gain on sale as unrelated business taxable income to tax-exempt investors If (1) all or a portion of our assets are subject to the rules relating to taxable mortgage pools, (2) we are a "pension-held REIT," (3) a tax-exempt stockholder has incurred debt to purchase or hold our common stock, or (4) the residual REMIC interests we buy generate "excess inclusion income," then a portion of the distributions to and, in the case of a stockholder described in (3), gains realized on the sale of common stock by such tax-exempt stockholder may be subject to Federal income tax as unrelated business taxable income under the Internal Revenue Code. Classification as a taxable mortgage pool could subject us to increased taxation If we have borrowings with two or more maturities and, (1) those borrowings are secured by mortgage loans or mortgage-backed securities and, (2) the payments made on the borrowings are related to the payments received on the underlying assets, then the borrowings and the pool of mortgage loans or mortgage backed securities to which such borrowings relate may be classified as a taxable mortgage pool under the Internal Revenue Code. If any part of our company were to be treated as a taxable mortgage pool, then our REIT status would not be impaired, but a portion of the taxable income we recognize may, under regulations to be issued by the Treasury Department, be characterized as "excess inclusion" income and allocated among our stockholders to the extent of and generally in proportion to the distributions we make to each stockholder. Any excess inclusion income would: o not be allowed to be offset by a stockholder's net operating losses; o be subject to a tax as unrelated business

income if a stockholder were a tax-exempt stockholder; o be subject to the application of federal income tax withholding at the maximum rate (without reduction for any otherwise applicable income tax treaty) with respect to amounts allocable to foreign stockholders; and o be taxable (at the highest corporate tax rate) to us, rather than to our stockholders, to the extent the excess inclusion income relates to stock held by disqualified organizations (generally, tax-exempt companies not subject to tax on unrelated business income, including governmental organizations). Based on advice of our tax counsel, we take the position that our existing financing arrangements do not create a taxable mortgage pool. Our operations may be adversely affected if we are subject to the Investment Company Act We intend to conduct our business at all times so as not to become regulated as an investment company under the Investment Company Act. The Investment Company Act exempts entities that are primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. In order to qualify for this exemption we must maintain at least 55% of our assets directly in mortgage loans, qualifying pass-through certificates and certain other qualifying interests in real estate. Our ownership of certain mortgage assets may be limited by the provisions of the Investment Company Act. If the Securities and Exchange Commission adopts a contrary interpretation with respect to these securities or otherwise believes we do not satisfy the above exception, we could be required to restructure our activities or sell certain of our assets. To insure that we continue to qualify for the exemption we may be required at times to adopt less efficient methods of financing certain of our mortgage assets and we may be precluded from acquiring certain types of higher-yielding mortgage assets. The net effect of these factors will be to lower at times our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption. If we conduct future offerings the market price of our securities may be adversely affected 42 We may elect to increase our capital resources by making additional private or public offerings of securities in the future. We do not know: o the actual or perceived effect of these offerings; o the timing of these offerings; o the dilution of the book value or earnings per share of our securities then outstanding; and o the effect on the market price of our securities then outstanding. Sales of additional common stock may adversely affect its market price The sale or the proposed sale of substantial amounts of our common stock in the public market could materially adversely affect the market price of our common stock or other outstanding securities. Based on a Schedule 13G filed with the SEC, as of February 15, 2002, HBK Master Fund L.P. beneficially owned 3,843,888 shares of our common stock, all of which are registered with the SEC for sale to the public pursuant to an effective registration statement. The sale of a large amount of shares by HBK Master Fund L.P., or the perception that such sales may occur, could adversely affect the market price for our common stock or other outstanding securities. We are a defendant in purported class actions and may not prevail in these matters We are a defendant in seven purported class actions pending in six different state courts; two cases in the United States District Court for the Western District of Tennessee and one in the United States District Court for the Northern District of Illinois. All, except for the Illinois matter, allege generally that the loan originator improperly charged fees in violation of various state lending or consumer protection laws in connection with mortgage loans that we acquired. The Illinois matter alleges that we charged fees for services that constitute the unauthorized practice of law and that were not proper charges. Although the suits are not identical, they generally seek unspecified compensatory damages, punitive damages, pre- and post-judgment interest, costs and expenses and rescission of the loans, as well as a return of any improperly collected fees. These actions are in the early stages of litigation and, accordingly, it is difficult to predict the outcome of these matters. We believe we have meritorious defenses to the actions and intend to defend against them vigorously; however, an adverse judgment in any of these matters could have a material adverse effect on us. We may be subject to possible adverse consequences as a result of limits on ownership of our shares Our charter limits ownership of our capital stock by any single stockholder to 9.5% of our outstanding shares unless waived by the board of directors. Our board of directors may increase the 9.5% ownership limit. In addition, to the extent consistent with the REIT provisions of the Internal Revenue Code, our board of directors may, pursuant to our articles of incorporation, waive the 9.5% ownership limit for a stockholder or purchaser of our stock. In order to waive the 9.5% ownership limit our board of directors must require the stockholder requesting the waiver to provide certain representations to the Company to ensure compliance with the REIT provisions of the Internal Revenue Code. Our charter also prohibits anyone from buying shares if the purchase would result in us losing our REIT status. This could happen if a share transaction results in fewer than 100 persons owning all of our shares or in five or fewer persons, applying certain broad attribution rules of the Internal Revenue Code, owning more than 50%

(by value) of our shares. If you or anyone else acquires shares in excess of the ownership limit or in violation of the ownership requirements of the Internal Revenue Code for REITs, we: o will consider the transfer to be null and void; o will not reflect the transaction on our books; o may institute legal action to enjoin the transaction; o will not pay dividends or other distributions with respect to those shares; o will not recognize any voting rights for those shares; o may redeem the shares; and o will consider the shares held in trust for the benefit of a charitable beneficiary as designated by us. The trustee shall sell the shares held in trust and the owner of the excess shares will be entitled to the lesser of: (a) the price paid by the owner; 43 (b) if the owner did not purchase for the excess shares, the closing price for the shares on the national securities exchange on which the company is listed; or (c) the price received by the trustee from the sale of the shares. Limitations on acquisition and change in control ownership limit The 9.5% ownership limit discussed above may have the effect of precluding acquisition of control of our company by a third party without consent of our board of directors. 44 Item 3: Quantitative and Qualitative Disclosures about Market Risk A significant portion of our revenues and earnings are derived from net interest income. We strive to manage our interest-earning assets and interest-bearing liabilities to generate what we believe to be an appropriate contribution from net interest income. When interest rates fluctuate, profitability can be adversely affected by changes in the fair market value of our assets and liabilities and by the interest spread earned on interest-earning assets and interest-bearing liabilities. We derive income from the differential spread between interest earned on interest-earning assets and interest paid on interest-bearing liabilities. Any change in interest rates affects income received and income paid from assets and liabilities in varying and typically unequal amounts. Changing interest rates may compress our interest rate margins and adversely affect overall earnings. Therefore, we seek to control the volatility of profitability due to changes in interest rates through asset/liability management. We attempt to achieve an appropriate relationship between interest rate sensitive assets and interest rate sensitive liabilities. Although we manage other risks, such as credit, operational, prepayment and liquidity risk in the normal course of business, we consider interest rate risk to be a significant market risk which could potentially have the largest material effect on our financial condition and results of operations. As we only invest or borrow in U.S. dollar denominated financial instruments, we are not subject to foreign currency exchange risk. We believe our quantitative risk has not materially changed since our disclosures under "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2001. We follow a hedging program intended to limit our exposure to changes in interest rates primarily associated with our CMO borrowings. Our primary objective is to hedge our exposure to the variability in future cash flows attributable to the variability of one-month LIBOR, which is generally the underlying index of our CMO borrowings. We also monitor on an ongoing basis the prepayment risks that arise in fluctuating interest rate environments. Our hedging program is formulated with the intent to offset the potential adverse effects of changing interest rates on CMO borrowings resulting from the following: interest rate adjustment limitations on mortgage loans due to periodic and lifetime interest rate cap features and mismatched interest rate adjustment periods of mortgage loans and CMO borrowings. We primarily acquire for long-term investment six-month ARMs and six month hybrids. Six-month LIBOR ARMs are generally subject to periodic and lifetime interest rate caps. This means that the interest rate of each ARM is limited to upwards or downwards movements on its periodic interest rate adjustment date, generally six months, or over the life of the mortgage loan. Periodic caps limit the maximum interest rate change, which can occur on any interest rate change date to generally a maximum of 1% per semiannual adjustment. Also, each ARM has a maximum lifetime interest rate cap. Generally, borrowings are not subject to the same periodic or lifetime interest rate limitations. During a period of rapidly increasing or decreasing interest rates, financing costs would increase or decrease at a faster rate than the periodic interest rate adjustments on mortgage loans would allow, which could effect net interest income. In addition, if the change in market rates were to exceed the maximum interest rates permitted change in the ARM rate, borrowing costs would increase while interest rates on ARMs would remain constant. Our mortgage loan portfolio is also subject to risk from the mismatched nature of interest rate adjustment periods on mortgage loans and interest rates on the related borrowings. Six-month ARMs can adjust upwards or downwards every six months, subject to periodic cap limitations, while adjustable rate CMO borrowings adjust every month. Additionally, hybrid ARMs have an initial fixed interest rate period generally ranging from two to three years, and to a lesser extent five years, which subsequently convert to six-month ARMs. Again, during a rapidly increasing or decreasing interest rate environment, financing costs would increase or decrease more rapidly than would interest rates on mortgage loans, which would remain fixed until their next interest rate adjustment date. To mitigate exposure from the effect of changing interest rates on CMO borrowings, we purchase and sell derivative instruments in the form

of interest rate cap agreements, or caps, interest rate floor agreements, or floors, and interest rate swap agreements, or swaps. We also simultaneously purchase or sell caps and floors, which are referred to as collars. These derivative instruments are referred to collectively as derivatives. An interest rate cap or floor is a contractual agreement. If prevailing interest rates reach levels specified in the cap or floor agreement, we may either receive or pay cash. An interest rate swap is generally a contractual agreement that obligates one party to receive or make cash payments based on an adjustable rate index and the other party to make or receive cash payments based on a fixed rate. Swap agreements have the effect of fixing borrowing costs on a similar amount of 45 swaps and, as a result, we can reduce the interest rate variability of borrowings. Our objective is to lock in a reliable stream of cash flows when interest rates fall below or rise above certain levels. For instance, when interest rates rise, borrowing costs increase at greater speeds than the underlying collateral supporting the borrowings. These derivative instruments hedge the variability of forecasted cash flows attributable to CMO borrowings and protect net interest income by providing cash flows at certain triggers during changing interest rate environments. In all hedging transactions, counterparties must have at least a single "A" credit rating as determined by various credit rating agencies. Caps qualify as derivative instruments under provisions of SFAS 133. The hedging instrument is the specific LIBOR cap that is hedging the LIBOR based CMO borrowings. The nature of the risk being hedged is the variability of the cash flows associated with the LIBOR borrowings. Prior to the adoption of DIG G20, we assessed the hedging effectiveness of our caps utilizing only the intrinsic value of the caps. DIG G20 allows us to utilize the terminal value of the caps to assess effectiveness. DIG G20 also allows us to amortize the initial fair value of the caps over the life of the caps based on the maturity date of the individual caplets. Upon adoption of DIG G20, net income and accumulated other comprehensive income were adjusted by the amount needed to reflect the cumulative impact of adopting the provisions of DIG G20. Subsequent to the adoption of DIG G20, caps are considered effective hedges and are marked to market each reporting period with the entire change in market value being recognized in other comprehensive income on the balance sheet. Floors, swaps and collars qualify as cash flow hedges under the provisions of SFAS 133. The hedging instrument is the specific LIBOR floor, swap or collar that is hedging the LIBOR based CMO borrowings. The nature of the risk being hedged is the variability of the cash flows associated with the LIBOR borrowings. Prior to DIG G20, these derivatives were marked to market with the entire change in the market value of the intrinsic component recognized in other comprehensive income on the balance sheet each reporting period. The time value component of these agreements were marked to market and recognized in non-interest expense on the statement of operations. Subsequent to the adoption of DIG G20, these derivatives are marked to market with the entire change in the market value recognized in other comprehensive income on the balance sheet. Measuring the effectiveness of derivatives is straightforward since the hedged item, CMO borrowings, and the hedging instrument is based on one-month LIBOR. As both instruments are tied to the same index, the hedge is expected to be highly effective both at inception and on an ongoing basis. We assess the effectiveness and ineffectiveness of the hedging instruments at the inception of the hedge and at each reporting period. Based on the fact that, at inception, the critical terms of the hedges and forecasted CMO borrowings are the same, we have concluded that the changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivatives, subject to subsequent assessments that the critical terms have not changed. At June 30, 2002, caps allocated to CMO borrowings had a remaining notional balance of $1.578 billion. Pursuant to the terms of the caps, we will receive cash payments if one-month LIBOR reaches certain strike prices, ranging from 1.84% to 10.25%, with a weighted average strike price of 4.38% over the life of the caps. At June 30, 2002, collars allocated to CMO borrowings had a remaining notional balance of $1.179 billion. Pursuant to the terms of the collars, we will receive cash payments if one-month LIBOR reaches strike prices ranging from 2.09% to 6.53% with a weighted average strike price of 4.24% over the life of the collars. We will make cash payments if one-month LIBOR reaches strike prices ranging from 1.54% to 5.88% with a weighted average strike price of 3.42%. At June 30, 2002, swaps allocated to CMO borrowings had a remaining notional balance of $65.0 million. Pursuant to the terms of the swaps, we will receive cash payments based on one-month LIBOR and make cash payments at fixed rates ranging from 4.83% to 5.17%, with a weighted average fixed rate of 4.94% over the life of the swaps. The notional amounts of allocated caps, collars and swaps are amortized according to projected prepayment rates on CMO borrowings. However, regarding the floor component of the collar, the notional amount equals the actual principal balance of the CMO borrowings. As of June 30, 2002, the fair market value of the allocated caps, collars and swaps was an unrecognized loss of $12.3 million. These derivatives are marked to market each reporting period with the entire change in market value being recognized in other comprehensive income on the balance sheet. 46 During 2001, we

purchased a collar at strike prices tied to the one-month LIBOR forward yield curve to protect cash flows on CMO borrowings, which are secured by hybrid ARMs with remaining fixed terms and that did not have derivative instruments allocated to the original CMO structures. As of June 30, 2002, the collar had a notional amount of $623.9 million with a one-month LIBOR cap strike price ranging from 4.55% to 5.42% and a weighted average strike price of 5.04% over the life of the cap. The collar has a one-month LIBOR floor strike price ranging from 4.35% to 4.98% and a weighted average strike price of 4.58% over the life of the floor. The collar matures on March 25, 2004. The notional amount of the collar is amortized according to projected prepayment rates reflected in CMO borrowings. As of June 30, 2002, the fair market value of the collar was an unrecognized loss of $13.2 million. The collar is marked to market each reporting period with the entire change in market value being recognized in accumulated other comprehensive income on the balance sheet. During the second quarter of 2002, we purchased a portfolio of interest floors at strike prices tied to the prevailing one-month LIBOR forward curve to protect hedged cash flows from the effects of continued interest rate declines consistent with a weakening economy. As of June 30, 2002, the floors had a notional amount of $623.9 million with one-month LIBOR floor strike prices ranging from 1.92% to 4.78% and a weighted average strike price of 3.09% over the life of the floor. The floor matures on March 25, 2004. The notional amount of the floor is amortized according to projected prepayment rates reflected in CMO borrowings. As of June 30, 2002, the fair market value of the floor was an unrecognized gain of $4.0 million. The floor is marked to market each reporting period with the entire change in market value being recognized in accumulated other comprehensive income on the balance sheet. The most significant variable in the determination of gain on sale in a securitization is the spread between the weighted average coupon on the securitized loans and the pass-through interest rate. In the interim period between loan origination or purchase and securitization or sale of such loans, we are exposed to interest rate risk. Most of the loans are securitized or sold within 30 to 45 days of origination of purchase. However, a portion of the loans are held-for-sale or securitization for as long as 12 months (or longer, in very limited circumstances) prior to securitization or sale. If interest rates rise during the period that the mortgage loans are held, in the case of a securitization, the spread between the weighted average interest rate on the loans to be securitized and the pass-through interest rates on the securities to be sold (the latter having increased as a result of market rate movements) would narrow. Upon securitization or sale, this would result in a reduction of our related gain or an increase in our loss on sale. We had interest- and principal-only strips of $2.9 million and $4.9 million outstanding at June 30, 2002 and December 31, 2001, respectively. These instruments are carried at market value at June 30, 2002 and December 31, 2001. We value these assets based on the present value of future cash flow streams net of expenses using various assumptions. These assets are subject to risk of accelerated mortgage prepayment or losses in excess of assumptions used in valuation. Ultimate cash flows realized from these assets would be reduced should prepayments or losses exceed assumptions used in the valuation. Conversely, cash flows realized would be greater should prepayments or losses be below expectations. 47 PART II. OTHER INFORMATION Item 1: Legal Proceedings The Company is a party to litigation and claims, which are normal in the course of its operations. While the results of such litigation and claims cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on the Company. Item 2: Changes in Securities and Use of Proceeds None. Item 3: Defaults Upon Senior Securities None. Item 4: Submission of Matters to a Vote of Security Holders On June 25, 2002, the Company held its annual meeting of stockholders. Of 39,422,163 shares eligible to vote, 38,175,264 votes were returned, or 97%, formulating a quorum. At the stockholders meeting, the following matters were submitted to stockholders for vote: Proposal I - Election of Directors, Proposal II - Approval of an amendment to the Company's articles of incorporation increasing the authorized shares of common stock. The results of voting on these proposals are as follows: Proposal I - Election of Directors Director For Against Elected -------- --- ------- ------- Joseph R. Tomkinson 37,169,606 1,005,658 Yes William S. Ashmore 37,169,106 1,006,158 Yes James Walsh 38,020,556 154,708 Yes Frank P. Filipps 38,020,556 154,708 Yes Stephan R. Peers 38,020,556 154,708 Yes William E. Rose 38,020,556 154,708 Yes Leigh J. Abrams 38,019,556 155,708 Yes All directors are elected annually at the Company's annual stockholders meeting. Proposal II - Approval of an amendment to the Company's articles of incorporation increasing the authorized shares of common stock Proposal II was approved with 35,546,864 shares voted for, 2,468,752 voted against, and 159,645 abstained from voting thereby approving the amendment to the Company's articles of incorporation increasing the authorized shares of common stock from 50,000,000 common shares to 200,000,000 common shares. Item 5: Other Information None. 48 Item 6: Exhibits and Reports on Form 8-K (a) Exhibits: 3.1(h) Articles Supplementary, filed with the State Department of Assessments and Taxation of Maryland on

July 12, 2002, reclassifying Series C Preferred Stock of the Registrant (incorporated by reference to exhibit 9 of the Registrant's Form 8-A/A, Amendment No. 2). 3.1(i) Articles of Amendment, filed with the State Department of Assessments and Taxation of Maryland on July 17, 2002, increasing authorized shares of Common Stock of the Registrant (incorporated by reference to exhibit 10 of the Registrant's Form 8-A/A, Amendment No. 2). 10.1 Sales Agency Agreement dated May 22, 2002 between Impac Mortgage Holdings, Inc. and UBS Warburg LLC (incorporated by reference to exhibit 1.1 of the Registrant's Current Report on Form 8-K, dated May 22, 2002). (b) Reports on Form 8-K: 1 Current report on Form 8-K dated May 22, 2002 reporting Items 5 and 7, relating to the execution of a sales agency agreement. 49 SIGNATURES Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. IMPAC MORTGAGE HOLDINGS, INC. /s/ Richard J. Johnson by: Richard J. Johnson Executive Vice President and Chief Financial Officer (authorized officer of registrant and principal financial officer) Date: August 22, 2002 CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 In connection with the Quarterly Report of Impac Mortgage Holdings, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned, in the capacities and on the dates indicated below, hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to his knowledge: (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company. /s/ Joseph R. Tomkinson Joseph R. Tomkinson Chief Executive Officer August 22, 2002 /s/ Richard J. Johnson Richard J. Johnson Chief Financial Officer August 22, 2002 50