

NEW CENTURY FINANCIAL CORP
Form 10-Q/A
August 20, 2001

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Mark One)

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

For the Quarterly Period Ended June 30, 2001

or

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

For the transition period from _____ to _____

Commission file number 000-22633

NEW CENTURY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State of incorporation)

33-0683629
(IRS Employer Identification No.)

**18400 VON KARMAN, SUITE 1000, IRVINE,
CALIFORNIA**
(Address of principal executive offices)

92612
(zip code)

(949) 440-7030

(Registrant's telephone number, including area code)

Not Applicable

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

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

As of July 26, 2001, 16,636,364 shares of common stock of New Century Financial Corporation were outstanding.

EXPLANATORY NOTE

This amendment to Form 10-Q on Form 10-Q/A amends and restates Part I, Item 1 (see note 1 to the Condensed Consolidated Financial Statements of New Century Financial Corporation) and Part I, Item 3 of New Century Financial Corporation's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2001 filed with the Securities and Exchange Commission on July 27, 2001.

Item 1. Financial Statements

New Century Financial Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Dollars in thousands, except share data)
(Unaudited)

| | December 31, 2000 | June 30, 2001 |
|---|----------------------|-------------------|
| ASSETS: | | |
| Cash and cash equivalents | \$ 10,283 | \$ 9,073 |
| Loans receivable held for sale, net (notes 2 and 5) | 400,089 | 588,305 |
| Residual interests in securitizations (note 3) | 361,646 | 324,551 |
| Mortgage servicing assets (note 4) | 22,945 | 3,622 |
| Accrued interest receivable | 1,588 | 3,385 |
| Office property and equipment | 3,171 | 3,268 |
| Prepaid expenses and other assets | 37,439 | 28,722 |
| TOTAL ASSETS | \$ 837,161 | \$ 960,926 |
| LIABILITIES AND STOCKHOLDERS' EQUITY: | | |
| Warehouse and aggregation lines of credit (note 5) | \$ 404,446 | \$ 579,164 |
| Residual financing | 176,806 | 119,641 |
| Subordinated debt | 40,000 | 40,000 |
| Notes payable | 24,340 | 1,126 |
| Income taxes payable | 7,498 | 10,154 |
| Accounts payable and accrued liabilities | 24,040 | 45,884 |
| Deferred income taxes | 7,882 | 7,882 |
| Total liabilities | 685,012 | 803,851 |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value. Authorized 7,500,000 shares; 40,000 shares issued and outstanding; liquidation preference \$40,000 | | |
| Common stock, \$.01 par value. Authorized 45,000,000 shares; issued and outstanding 14,852,931 shares at December 31, 2000 and 15,175,009 shares at June 30, 2001 | 149 | 152 |
| Additional paid-in capital | 90,579 | 90,222 |
| Retained earnings, restricted | 61,426 | 68,018 |
| | 152,154 | 158,392 |
| Deferred compensation costs | (5) | (1,317) |
| Total stockholders' equity | 152,149 | 157,075 |

| | December 31, 2000 | June 30, 2001 |
|---|----------------------|------------------|
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 837,161 | \$ 960,926 |

See accompanying notes to unaudited condensed consolidated financial statements.

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New Century Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Operations
(Dollars in thousands, except per share amounts)
(Unaudited)

| | Six Months Ended June 30, | | Three Months Ended June 30, | |
|---|------------------------------|-----------------|--------------------------------|-----------------|
| | 2000 | 2001 | 2000 | 2001 |
| Revenues: | | | | |
| Gain (loss) on sale of loans | \$ 21,205 | \$ 58,679 | \$ (1,605) | \$ 38,129 |
| Interest income | 36,212 | 22,975 | 17,771 | 13,717 |
| Servicing income | 15,555 | 9,504 | 7,746 | 2,998 |
| Residual interest income | 22,805 | 20,684 | 11,481 | 9,530 |
| Other income | 540 | 907 | 540 | 420 |
| Total revenues | 96,317 | 112,749 | 35,933 | 64,794 |
| Expenses: | | | | |
| Personnel | 28,315 | 37,008 | 15,071 | 18,908 |
| Interest | 35,478 | 29,062 | 17,391 | 12,967 |
| General and administrative | 24,160 | 24,800 | 12,672 | 11,635 |
| Advertising and promotion | 7,407 | 5,158 | 3,943 | 2,374 |
| Professional services | 2,900 | 2,557 | 1,516 | 1,551 |
| Total expenses | 98,260 | 98,585 | 50,593 | 47,435 |
| Earnings (loss) before income taxes (benefit) | (1,943) | 14,164 | (14,660) | 17,359 |
| Income taxes (benefit) | (613) | 6,123 | (6,057) | 7,466 |
| Net earnings (loss) | \$ (1,330) | \$ 8,041 | \$ (8,603) | \$ 9,893 |
| Dividends paid on preferred stock | (1,450) | (1,450) | (725) | (725) |
| Net earnings (loss) available to common stockholders | \$ (2,780) | \$ 6,591 | \$ (9,328) | \$ 9,168 |
| Basic earnings (loss) per share (note 6) | \$ (0.19) | \$ 0.44 | \$ (0.63) | \$ 0.61 |
| Diluted earnings (loss) per share (note 6) | \$ (0.19) | \$ 0.41 | \$ (0.63) | \$ 0.51 |

See accompanying notes to unaudited condensed consolidated financial statements.

New Century Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Six Months Ended June 30, 2000 and 2001
(In thousands)
(Unaudited)

| | <u>2000</u> | <u>2001</u> |
|--|-----------------|-----------------|
| Cash flows from operating activities: | | |
| Net earnings (loss) | \$ (1,330) | \$ 8,041 |
| Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 4,849 | 3,326 |
| NIR gains | (35,116) | (16,347) |
| Initial deposits to over-collateralization accounts | (21,944) | (2,853) |
| Deposits to over-collateralization accounts | (40,416) | (43,761) |
| Release of cash from over-collateralization accounts | 31,500 | 33,433 |
| Servicing gains | (3,138) | (4,938) |
| Amortization (accretion) of NIRs | 15,562 | 18,522 |
| Fair value adjustment of residual securities | 21,197 | |
| Provision for losses | 5,850 | 5,441 |
| Loans originated or acquired for sale | (2,064,305) | (2,412,559) |
| Loan sales, net | 1,964,916 | 2,219,658 |
| Principal payments on loans receivable held for sale | 21,694 | 6,642 |
| Increase in warehouse and aggregation lines of credit | 69,875 | 174,718 |
| Net change in other assets and liabilities | (10,019) | 20,977 |
| | <u>(40,825)</u> | <u>10,300</u> |
| Cash flows from investing activities: | | |
| Purchase of office property and equipment | (746) | (1,171) |
| Stock issued in connection with acquisition of Primewest | (43) | |
| Proceeds from sale of residual interests in securitization | | 22,204 |
| Proceeds from sale of mortgage servicing rights | | 22,754 |
| | <u>(789)</u> | <u>43,787</u> |
| Cash flows from financing activities: | | |
| Net proceeds from (repayments of) residual financing | 27,798 | (31,268) |
| Proceeds from issuance of subordinated debt | 15,000 | |
| Proceeds from (net repayments of) notes payable | (912) | (23,214) |
| Payment of dividends on convertible preferred stock | (1,450) | (1,450) |
| Net proceeds from issuance of stock/purchase of treasury stock | (222) | 635 |
| | <u>40,214</u> | <u>(55,297)</u> |
| Net decrease in cash and cash equivalents | (1,400) | (1,210) |
| Cash and cash equivalents, beginning of period | 4,496 | 10,283 |

| | 2000 | 2001 |
|---|-----------|-----------|
| | \$ | \$ |
| Cash and cash equivalents, end of period | 3,096 | 9,073 |
| Supplemental cash flow disclosure: | | |
| Interest paid | \$ 35,570 | \$ 29,917 |
| Income taxes paid | \$ 4,212 | \$ 3,467 |
| Supplemental non-cash financing activity: | | |
| Stock issued in connection with acquisition | \$ 43 | \$ 125 |
| Restricted stock issued | \$ | \$ 1,520 |
| Cancellation of warrants | \$ | \$ 2,631 |
| Net assets acquired through acquisition of subsidiary | \$ 553 | \$ |

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2000 and 2001

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ended December 31, 2001.

Recent accounting developments In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Securities and Hedging Activities," as amended by SFAS No. 137 and SFAS No. 138 (collectively "SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments imbedded in other contracts (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (i) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (ii) a hedge of the exposure to variable cash flows of a forecasted transaction, or (iii) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available for sale security, or a foreign currency-denominated forecasted transaction.

Under SFAS No. 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk. This statement is effective for the Company on January 1, 2001.

On January 1, 2001, the Company adopted SFAS No. 133. All outstanding derivatives at December 31, 2000 had already been recognized at fair value with the offset through earnings, consequently, the adoption of SFAS No. 133 did not result in any adjustment to the recorded value of the Company's derivative hedging instruments.

In September 2000, FASB issued SFAS No. 140 to replace SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140). SFAS No. 140 provides the accounting and reporting guidance for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 will be the authoritative accounting literature for: (1) securitization transactions involving financial assets; (2) sales of financial assets; (3) servicing assets and liabilities; (4) securities lending transactions; (5) repurchase agreements; and (6) extinguishments of liabilities. The accounting provisions are effective for fiscal years beginning after March 31, 2001. The reclassification and disclosure provisions are effective for fiscal years beginning after December 15, 2000. The Company adopted the disclosure provisions required by SFAS No. 140 and has included all appropriate and necessary disclosures required by SFAS No. 140 in its financial statements and footnotes. The adoption of this standard did not have a material impact on the Company's consolidated balance sheet or results of operations.

The Emerging Issues Task Force (EITF) consensus 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, provides guidance for interest income recognition and measurement of impairment for interests retained in a securitization. This consensus was required to be implemented by the Company on April 1, 2001. The consensus had no significant impact on the consolidated balance sheet or results of operations.

In July, 2001, FASB issued SFAS No. 141, "Accounting for Business Combinations" and SFAS No. 142, "Accounting for Goodwill and Intangible Assets." SFAS No. 141 eliminates the ability to utilize the pooling of interests method of accounting for business combination transactions initiated after June 30, 2001. The purchase method of accounting is now required. SFAS 142 eliminates the existing requirement to amortize goodwill through a periodic charge to earnings. For existing goodwill, the elimination of the amortization requirement is effective for the Company beginning January 1, 2002. As of that date, and at least annually thereafter, goodwill must be evaluated for impairment based on estimated fair value. As of June 30, 2001, the Company had goodwill of \$3.6 million. Since the goodwill and related amortization has not been significant to the consolidated balance sheet and results of operations, the implementation of this standard is not expected to be material to the consolidated balance sheet or results of operations.

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

The loan securitizations are generally structured as follows: First, the Company sells a portfolio of mortgage loans to a special purpose entity (SPE) which has been established for the limited purpose of buying and reselling mortgage loans. The SPE then transfers the same mortgage loans to a Real Estate Mortgage Investment Conduit or Owners Trust (the REMIC or Trust), and the Trust in turn issues interest-bearing asset-backed securities (the Certificates) generally in an amount equal to the aggregate principal balance of the mortgage loans. The Certificates are typically sold at face value and without recourse except that representations and warranties customary to the mortgage banking industry are provided by the Company to the Trust. One or more investors purchase these Certificates for cash. The Trust uses the cash proceeds to pay the Company the cash portion of the purchase price for the mortgage loans. The Trust also issues a certificate representing a residual interest in the payments on the securitized loans. In addition, the Company may provide a credit enhancement for the benefit of the investors in the form of additional collateral (over-collateralization account or OC Account) held by the Trust. The OC Account is required by the servicing agreement to be maintained at certain levels.

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

The NIMS are generally structured as follows. First, the Company sells or contributes the Residuals to an SPE which has been established for the limited purpose of receiving and selling asset-backed residual interests in securitization certificates. Next, the SPE transfers the Residuals to an owner trust (the Trust) and the Trust in turn issues interest-bearing asset-backed securities (the bonds and certificates). The Company sells these Residuals without recourse except that normal representations and warranties are provided by the Company to the Trust. One or more investors purchase the bonds and certificates and the proceeds from the sale of the bonds and certificates, along with a residual interest certificate that is subordinate to the bonds and certificates, represent the consideration to the Company for the sale of the Residuals.

At the closing of each NIMS, the Company removes from its consolidated balance sheet the carrying value of the Residuals sold and adds to its consolidated balance sheet (i) the cash received, and (ii) the estimated fair value of the portion of the Residuals retained, which consists of the net

interest receivable (NIR) and the OC account. The excess of the cash received and assets retained over the carrying value of the Residuals sold, less transaction costs, equals the net gain or loss on the sale of Residuals recorded by the Company.

The Company allocates its basis in the mortgage loans and residual interests between the portion of the mortgage loans and residual interests sold through the Certificates and the portion retained (the Residuals and servicing assets) based on the relative fair values of those portions on the date of sale. The Company may recognize gains or losses attributable to the changes in the fair value of the Residuals, which are recorded at

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estimated fair value and accounted for as "held-for-trading" securities. The Company is not aware of an active market for the purchase or sale of Residuals and, accordingly, the Company determines the estimated fair value of the Residuals by discounting the expected cash flows released from the OC Account (the cash out method) using a discount rate commensurate with the risks involved. The Company utilizes an effective discount rate of 13% on the estimated cash flows released from the OC Account to value the Residuals through securitization and a range of 15% to 20% on the estimated cash flows released from the Trust to value Residuals through NIMS transactions.

In securitization transactions, generally the Company has the right to collect periodic servicing fees for the servicing and collection of the mortgage loans as master servicer of the securitized loans. In addition, the Company is entitled to the cash flows from the Residuals that represent collections on the mortgage loans in excess of the amounts required to pay the Certificate principal and interest, the servicing fees and certain other fees such as trustee and custodial fees. At the end of each collection period, the aggregate cash collections from the mortgage loans are allocated first to the base servicing fees and certain other fees such as trustee and custodial fees for the period, then to the Certificateholders for interest at the pass-through rate on the Certificates plus principal as defined in the servicing agreements. If the amount of cash required for the above allocations exceeds the amount collected during the collection period, the shortfall is drawn from the OC Account. If the cash collected during the period exceeds the amount necessary for the above allocations, and there is no shortfall in the related OC Account, the excess is released to the Company. If the OC Account balance is not at the required credit enhancement level, the excess cash collected is retained in the OC Account until the specified level is achieved. The cash and collateral in the OC Account is restricted from use by the Company. Pursuant to certain servicing agreements, cash held in the OC Accounts may be used to make accelerated principal paydowns on the Certificates to create additional excess collateral in the OC Account which is held by the Trusts on behalf of the Company as the Residual holder. The specified credit enhancement levels are defined in the servicing agreements as the OC Account balance expressed generally as a percentage of the current collateral principal balance.

For NIMS transactions, the Company will receive cash flows once the holders of the senior bonds and certificates created in the NIMS transaction are fully repaid.

The Annual Percentage Rate (APR) on the mortgage loans is relatively high in comparison to the pass-through rate on the Certificates. Accordingly, the Residuals described above are a significant asset of the Company. In determining the value of the Residuals, the Company must estimate the future rates of prepayments, prepayment penalties to be received by the Company, delinquencies, defaults and default loss severity as they affect the amount and timing of the estimated cash flows. As of June 30, 2001, the ranges of significant assumptions used to determine the present value of estimated future cash flows from the Residuals were:

| | Adjustable Rate | Fixed Rate |
|------------------------|--------------------|--------------------|
| Cumulative pool losses | 2.06% to 3.50% | 2.75% to 4.06% |
| Weighted average life | 2.09 to 3.43 years | 4.33 to 4.41 years |

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Cumulative pool losses represent the total actual plus expected losses, divided by the original pool balance. The variations between the low and the high end of the range for losses and weighted average lives are the result of different assumptions used for each security. These assumptions are affected by such factors as the age of the security, the product mix in the collateral pool, the existence of mortgage insurance coverage, prepayment penalty coverage, and various other factors. These estimates are based on historical loss data for comparable loans and the specific characteristics of the loans originated by the Company. The Company estimates prepayments by evaluating historical prepayment performance of comparable mortgage loans and the impact of trends in the industry. The Company has used a prepayment curve to estimate the prepayment characteristics of the mortgage loans. The rate of increase, duration, severity and decrease of the curve depends on the age and nature of the mortgage loans, primarily whether the mortgage loans are fixed or adjustable and the interest rate adjustment characteristics of the mortgage loans (6 month, 1 year, 2 year, 3 year or 5 year adjustment periods).

Historically, the Company performs an evaluation of its Residuals quarterly, which takes into consideration trends in actual cash flow performance, industry and economic developments, as well as other relevant factors. Although recent experience resulted in an increase in prepayment and loss assumptions as of June 30, 2001, the current interest rate environment resulted in an increase in value such that the carrying value of the Residuals is at fair market value at June 30, 2001. For the quarter ended June 30, 2000, the Company recorded a market value adjustment of \$21.2 million to reduce the carrying value of the Residuals, and charged off the \$5.0 million general valuation allowance. The combined \$26.2 million reduction in the carrying value of the Residuals resulted from an increase of 1% in the discount rate used to calculate the present value of estimated future cash flows, as well as increases in the prepayment and loss assumptions.

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

2. Loans Receivable Held for Sale, Net

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A summary of loans receivable held for sale, at the lower of cost or market at December 31, 2000 and June 30, 2001 follows (dollars in thousands):

| | December 31, 2000 | June 30, 2001 |
|-------------------------------|----------------------|-------------------|
| Mortgage loans receivable | \$ 401,139 | \$ 588,895 |
| Net deferred origination fees | (1,050) | (590) |
| | <u>\$ 400,089</u> | <u>\$ 588,305</u> |

3. Residual Interests in Securitizations

Residual interests in securitizations consist of the following components at June 30, 2001 and December 31, 2000 (dollars in thousands):

| | December 31, 2000 | June 30, 2001 |
|--------------------------------|----------------------|-------------------|
| Over-collateralization account | \$ 242,636 | \$ 204,556 |
| Net interest receivable (NIR) | 119,010 | 119,995 |
| | <u>\$ 361,646</u> | <u>\$ 324,551</u> |

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The following table summarizes activity in the NIR amounts for the six months ended June 30, 2000 and 2001 (dollars in thousands):

| | 2000 | 2001 |
|--|-------------------|-------------------|
| Balance, beginning of period | \$ 185,144 | \$ 119,010 |
| NIR gains | 35,116 | 16,347 |
| Sales of NIR through NIM's/call transactions | | 3,160 |
| Charge-offs of NIR | (5,000) | |
| Fair value adjustment | (21,197) | |
| NIR accretion (amortization) | (15,562) | (18,522) |
| Balance, end of period | <u>\$ 178,501</u> | <u>\$ 119,995</u> |

The call transactions represent (i) the effect of the January 2001 exercise of the call option for the Company's 1998-NC5 securitization transaction; and (ii) the effect of the June 2001 clean-up call on the Company's first three securitization transactions, NC97-1, NC97-2 and NC97-3.

The following table summarizes activity in the OC accounts for the six months ended June 30, 2000 and 2001 (dollars in thousands):

| | 2000 | 2001 |
|------------------------------------|-------------------|-------------------|
| Balance, beginning of period | \$ 184,545 | \$ 242,636 |
| Initial deposits to OC accounts | 21,944 | 2,853 |
| Call transactions | | (51,261) |
| Additional deposits to OC accounts | 40,416 | 43,761 |
| Release of cash from OC accounts | (31,500) | (33,433) |
| Balance, end of period | <u>\$ 215,405</u> | <u>\$ 204,556</u> |

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The following table summarizes activity in the allowance for NIR losses for the six months ended June 30, 2000 and 2001 (dollars in thousands):

| | 2000 | 2001 |
|-------------------------------|-----------|-----------|
| Balance, beginning of period | \$ 5,000 | \$ |
| Charge-offs of NIR | (5,000) | |
| Balance, end of period | \$ | \$ |

4. Mortgage Servicing Assets

Mortgage servicing assets represent the carrying value of the Company's servicing portfolio. The following table summarizes activity in mortgage servicing assets for the six months ended June 30, 2000 and 2001 (dollars in thousands):

| | 2000 | 2001 |
|-------------------------------|------------------|-----------------|
| Balance, beginning of period | \$ 22,145 | \$ 22,945 |
| Additions | 3,138 | 4,938 |
| Sales of servicing rights | | (22,754) |
| Amortization | (2,912) | (1,507) |
| Balance, end of period | \$ 22,371 | \$ 3,622 |

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The table below summarizes activity in the Company's mortgage loan servicing portfolio for the six months ended June 30, 2000 and 2001 (dollars in millions):

| | 2000 | 2001 |
|----------------------------------|-----------------|-----------------|
| Balance, beginning of period | \$ 5,950 | \$ 6,080 |
| Loans funded | 2,066 | 2,410 |
| Bulk sale of servicing rights | | (5,969) |
| Payoffs/servicing-released sales | (2,044) | (1,182) |
| Balance, end of period | \$ 5,972 | \$ 1,339 |

During the six months ended June 30, 2001, the Company sold servicing rights in four separate transactions. The first transaction was the sale of servicing rights to \$4.8 billion in loans, for which the Company will perform subservicing until third quarter of 2001. The second transaction was the sale of servicing rights to \$520 million in loans, for which the servicing transferred to the purchaser prior to the end of the first quarter of 2001. The third transaction was the sale of servicing rights to \$380 million in loans securitized during the second quarter, and the fourth transaction was the sale of servicing rights to \$317 million in loans sold through whole loan sales early in the second quarter.

5. Warehouse and Aggregation Lines of Credit

Warehouse and aggregation lines of credit consist of the following at December 31, 2000 and June 30, 2001 (dollars in thousands):

| | December 31, 2000 | June 30, 2001 |
|---|----------------------|------------------|
| A \$300 million line of credit expiring in May 2002 secured by loans receivable held for sale, bearing interest based on one month LIBOR (3.86% at June 30, 2001) | \$ 201,705 | \$ 275,045 |

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| | December 31, 2000 | June 30, 2001 |
|---|-----------------------------|-----------------------------|
| | <u> </u> | <u> </u> |
| A \$500 million master repurchase agreement bearing interest based on one month LIBOR (3.86% at June 30, 2001), secured by loans receivable held for sale. The agreement may be terminated by the lender after giving 28 days written notice and expires in December 2001 | 167,522 | 177,512 |
| A \$400 million loan and security agreement bearing interest based on one-month LIBOR (3.86% at June 30, 2001), secured by loans receivable held for sale, expiring in November 2001 | 29,071 | 124,883 |
| A \$300 million loan and security agreement bearing interest based on one-month LIBOR, secured by loans receivable held for sale, cancelled in February 2001 by the Company | 639 | |
| A \$25 million master loan and security agreement bearing interest based on one month LIBOR (3.86% at June 30, 2001), secured by delinquent loans and REO properties, expiring in December 2001 | 3,952 | 1,724 |
| A \$298 million loan and security agreement bearing interest based on one month LIBOR, secured by loans receivable held for sale, renewing automatically for successive 12-month periods starting in August 2000, but is uncommitted | 1,557 | |
| | <u> </u> | <u> </u> |
| | \$ 404,446 | \$ 579,164 |
| | <u> </u> | <u> </u> |

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The warehouse and aggregation line of credit agreements contain certain restrictive financial and other covenants which require the Company to, among other things, restrict dividends, maintain certain net worth and liquidity levels, remain below specified debt-to-net-worth ratios and comply with regulatory and investor requirements. At June 30, 2001, the Company was in compliance with all material financial and other covenants in its warehouse and aggregation facilities.

6. Earnings per Share

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

| | Six Months Ended June 30, | | Three Months Ended June 30, | |
|--|------------------------------|-----------------------------|--------------------------------|-----------------------------|
| | 2000 | 2001 | 2000 | 2001 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Basic: | | | | |
| Net earnings (loss) | \$ (1,330) | \$ 8,041 | \$ (8,603) | \$ 9,893 |
| Less: dividends declared on preferred stock | (1,450) | (1,450) | (725) | (725) |
| Earnings (loss) available to common stockholders | <u>(2,780)</u> | <u>6,591</u> | <u>(9,328)</u> | <u>9,168</u> |
| Weighted average common shares outstanding | 14,681 | 14,964 | 14,700 | 15,020 |
| Earnings (loss) per share | <u>\$ (0.19)</u> | <u>\$ 0.44</u> | <u>\$ (0.63)</u> | <u>\$ 0.61</u> |
| Diluted: | | | | |

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| | Six Months Ended June 30, | | Three Months Ended June 30, | |
|--|------------------------------|----------|--------------------------------|----------|
| Net earnings (loss), as adjusted | \$ (2,780) | \$ 8,041 | \$ (9,328) | \$ 9,893 |
| Weighted average number of common and common equivalent shares outstanding | 14,681 | 14,964 | 14,700 | 15,020 |
| Dilutive effect of convertible preferred stock, stock options and warrants | | 4,491 | | 4,469 |
| | 14,681 | 19,455 | 14,700 | 19,489 |
| Earnings (loss) per share | \$ (0.19) | \$ 0.41 | \$ (0.63) | \$ 0.51 |

For the three and six months ended June 30, 2001, 1,027,000 stock options and 50,000 warrants are excluded from the calculation of diluted earnings per share because their effect is anti-dilutive. For the three and six months ended June 30, 2000, 2,373,387 stock options, 737,500 warrants and 40,000 shares of convertible preferred stock (convertible into 4,124,400 shares of common stock) are excluded from the calculation of diluted earnings per share because their effect is anti-dilutive.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk generally represents the risk of loss that may result from the potential change in the value of a financial instrument due to fluctuations in interest rates. Market risk is inherent to both derivative and non-derivative financial instruments, and accordingly, the scope of our market risk management includes all market risk sensitive financial instruments.

We monitor the value of our residual interests using various scenarios for interest rate, prepayment and loss assumptions. Certain financial instruments perform poorly in an increasing or decreasing interest rate environment, other instruments may perform well, and others may not be impacted at all.

We use several tools and risk management strategies to monitor and address interest rate risk. Such tools allow us to monitor and evaluate our exposure to these risks and to manage the risk profile of our residual interest portfolio in response to changes in the market risk.

We measured the sensitivity of the current value of our residual interests to changes in interest rates. Changes in interest rates are defined as instantaneous and sustained parallel interest rate movements in 50 basis point increments in the forward LIBOR curve. We estimated the fair value of our residual interests assuming there would be no changes in interest rates from those at period end. Once we established the base case, we projected cash flows for each of the defined interest rate scenarios. These projections were then compared with the base case to determine the estimated change to the fair value of our residual interests.

The following table summarizes the sensitivity analysis of change in the fair value of our residual interests as of December 31, 2000 and June 30, 2001:

| | Change in fair value as of: | |
|------------------------------|-----------------------------|---------------|
| | December 31, 2000 | June 30, 2001 |
| Increase of 100 basis points | (6.4)% | (5.2)% |
| Increase of 50 basis points | (3.0)% | (2.7)% |
| Decrease of 50 basis points | 5.9 % | 2.8 % |
| Decrease of 100 basis points | 8.3 % | 5.6 % |

(1) Change in fair value is measured based on the increase or decrease in value assuming a parallel shift in the forward LIBOR curve.

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 hereunto duly authorized.

NEW CENTURY FINANCIAL CORPORATION

DATE: August 20, 2001

By: /s/ BRAD A. MORRICE

Brad A. Morrice
President

DATE: August 20, 2001

By: /s/ EDWARD F. GOTSCHALL

Edward F. Gotschall
*Chief Financial Officer (Principal Financial and
Accounting Officer)*

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EXPLANATORY NOTE

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[Condensed Consolidated Statements of Operations](#)

[Condensed Consolidated Statements of Cash Flows](#)

[Notes to Condensed Consolidated Financial Statements](#)

SIGNATURES