NEW CENTURY FINANCIAL CORP
Form 10-Q
November 09, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005.**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _________ TO _________**

COMMISSION FILE NUMBER: 001-32314

NEW CENTURY FINANCIAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

18400 VON KARMAN, SUITE 1000,

IRVINE, CALIFORNIA 92612

(Address of principal executive offices)(Zip Code)

(949) 440-7030

(Registrant s telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). x Yes ¨ No

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. ¨ Yes ¨ No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

As of October 31, 2005, the registrant had 56,634,524 shares of common stock outstanding.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2005

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Certain information included in this Quarterly Report on Form 10-Q may include forward-looking statements under federal securities laws, and the company intends that such forward-looking statements be subject to the safe-harbor created thereby. Such statements include, without limitation, (i) the company s expectation that the acquisition of certain assets and related liabilities of RBC Mortgage Company will enable it to expand its mortgage product offerings to include conventional mortgage loans, loans insured by the Federal Housing Administration and loans guaranteed by the Veterans Administration, its retail presence on a nationwide basis and its channels of distribution, particularly into the realtor and builder channels; (ii) management s projections with respect to the company s loan loss allowances; (iii) the estimates and assumptions used by the company in determining the value of its residual interests in securitizations; (iv) the company s estimates with respect to the cumulative losses of its securitizations; (v) the company s prepayment curve and default estimates for its adjustable-rate and fixed-rate securities; (vi) the company s estimated weighted average life of its securitizations; (vii) the company s estimates with respect to the average life of its securitized loan pools; (viii) the company s intention to apply any excess taxable REIT income at year-end to its regular first quarter 2006 dividend payment; (ix) the company s intention to fund its stock repurchase program with excess corporate liquidity; (x) the company s expectation that stock repurchases will be made on the open market through block trades or in privately negotiated sales; (xi) the company s expectation that the number of shares to be purchased under the stock repurchase program and the timing of the repurchases will be based on the level of the company s cash balances, general business conditions and other factors including alternative investment opportunities; (xii) the company s right to terminate, suspend, reduce or increase the size of its stock repurchase program at any time; (xiii) the company s belief that its REIT structure provides the most tax-efficient way to hold loans on its balance sheet; (xiv) the company s expectation that it will retain approximately 20% of its total loan production for investment on its balance sheet through securitizations structured as financings for 2005; (xv) the company s expectation that a significant source of its revenues will be interest income generated from its portfolio of mortgage loans held by its REIT and its qualified REIT subsidiaries; (xvi) the company s expectation that it will also be able to continue to generate revenue through its taxable REIT subsidiaries from the sale of loans, servicing income and loan origination fees; (xvii) the company s expectation that the primary components of its expenses will be interest expense on its credit facilities, securitizations and other borrowings, general and administrative expenses and payroll and related expenses arising from the company s loan origination and servicing business; (xviii) the company s belief that being a full-service mortgage provider will allow it to build upon the success of its Home123 branding and marketing campaign; (xix) the company s expectation that the RBC Mortgage Company acquisition will be slightly dilutive to its earnings per share in 2005 (by approximately $0.10 per share) and accretive to its earnings per share for the 12 months following the acquisition; (xx) the company s intention that it will continue to raise its interest rates with a view toward expanding its overall operating margin; (xxi) the company s intention to manage its cost structure to remain efficient even if loan origination volume declines; (xxii) the company s expectation that its overall margins will remain at low levels during the fourth quarter of 2005; (xxiii) the company s intention to continue to focus on maximizing the net execution of its whole loan sales and, to the extent advantageous, execute securitizations structured as sales at the taxable REIT subsidiary level; (xxiv) the company s expectation that it will continue its cost-cutting strategies; (xxv) the company s expectation that its loan production will be sold through whole loan sales and, to a lesser extent, securitizations structured as sales for the remainder of 2005 and in the near term; (xxvi) the company s intention to concentrate significant efforts on a successful integration of the former RBC Mortgage Company business that the company expects will ultimately allow it to offer a wider range of products to all of its customers and add strong builder and realtor relationships to its loan origination business; (xxvii) the company s assumption that its cumulative credit losses are approximately 3% of the original balance of the loans; (xxvii) the company s belief that its loan production volume may decrease as a result of higher interest rates on the mortgages its originates; (xxviii) the company s expectation that any positive impact of its steps to improve its operating margins will most likely occur in the first and second quarters of 2006; (xxix) the company s expectation that it may continue to utilize securitizations structured as sales in order to maximize the secondary market value of its loan production; (xxx) the company s expectation that it will measure the profitability of the loan origination platform acquired from RBC Mortgage Company using operating margin as the most important metric; (xxxi) the company s intention to integrate its product channels in the coming quarters; (xxxii) the company s belief that its stricter underwriting guidelines and the stronger credit characteristics of its interest-only loans mitigate their perceived higher risk; (xxxiii) the company s intention to reduce the production volume of its interest-only product to 25% of total loan production through pricing increases, underwriting changes and new product offerings; (xxxiv) the company s expectation that given the actual and anticipated timing of its investments and securitizations, its reported earnings in the second half of 2005 will exceed its reported earnings in the first half of 2005; (xxxv) the company s expectation that the volume of discounted loan sales will likely return to normal levels in the fourth quarter of 2005; (xxxvi) the company s underlying assumptions used to value its residual interests in securitizations and to determine the discount rates of projected cash flows for its residual interests and for residual interests through NIMS transactions (as described in this Quarterly Report on Form 10-Q); (xxxvii) the estimates and assumptions required by the company s accounting policies; (xxxviii) the company s estimates and assumptions with respect to the interest rate environment; (xxxix) the company s estimates and assumptions with respect to the economic environment; (xl) the company s estimates and assumptions with respect to secondary market conditions; (xli) the company s estimates and assumptions with respect to the performance of the loans underlying its residual assets and mortgage loans held for investment; (xlii) the company s estimates with respect to losses incurred as a result of the recent Gulf Coast hurricanes; (xliii) the company s expectations with respect to the renewal or extension of its credit facilities; (xliv) the company s expectations regarding its target levels of liquidity and capital; (xlv) the company s successful execution of its liquidation strategy; (xlvi) the company s expectation that its liquidity, credit facilities and capital resources will be sufficient to fund its operations for the foreseeable future while enabling it to maintain its qualification as a REIT under the requirements of the Internal Revenue Code of 1986, as amended; (xlvii) the company s expectation that it will access the capital markets when appropriate to support its business operations; (xlviii) the company s intention to execute its stock repurchase program while maintaining its targeted cash and liquidity levels and preserving its flexibility to engage in a modest level of off-balance sheet securitizations if the company believes such transactions to be advantageous; (xlix) that the company s future declarations of dividends will be subject to its earnings, financial position, capital requirements, contractual restrictions and other relevant factors; and (l) the company s beliefs with respect to its legal proceedings.

The company cautions that these statements are qualified by important factors that could cause its actual results to differ materially from expected results in the forward-looking statements. Such factors include, but are not limited to, (i) the condition of the U.S. economy and financial system; (ii) the interest rate environment; (iii) the effect of increasing competition in the company s sector; (iv) the condition of the markets for whole loans and mortgage-backed securities; (v) the stability of residential property values; (vi) the company s ability to comply with the requirements applicable to REITs; (vii) the company s ability to increase its portfolio income; (viii) the company s ability to continue to maintain low loan acquisition costs; (ix) the potential effect of new state or federal laws and regulations; (x) the company s ability to maintain adequate credit facilities to finance its business; (xi) the outcome of litigation or regulatory actions pending against the company; (xii) the company s ability to adequately hedge the fair value of its assets and cash flows; (xiii) the accuracy of the assumptions regarding the company s repurchase allowance and residual valuations, prepayment speeds and loan loss allowance; (xiv) the ability to finalize forward sale commitments; (xv) the ability to deliver loans in accordance with the terms of forward sale commitments; (xvi) the assumptions underlying the company s risk management practices; and (xvii) the ability of the company s servicing platform to maintain high performance standards. Additional information on these and other factors is contained in the company s Annual Report on Form 10-K for the year ended December 31, 2004, the company s Quarterly Reports on Form 10-Q for the periods ended March 31, 2005 and June 30, 2005 and the company s other periodic filings with the Securities and Exchange Commission.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

September 30, 2005 and December 31, 2004

(Dollars in thousands, except share amounts)

	September 30, 2005 (unaudited)	December 31, 2004
Assets		
Cash and cash equivalents	$ 530,059	842,854
Restricted cash	771,341	454,035
Mortgage loans held for sale	8,570,862	3,922,865
Mortgage loans held for investment, net of allowance of $177,759 and $90,227, respectively	18,330,313	13,195,324
Residual interests in securitizations	172,111	148,021
Mortgage servicing assets	54,310	8,249
Accrued interest receivable	112,151	66,208
Income taxes, net	111,335	180,840
Office property and equipment, net	80,085	47,266
Goodwill, net	93,211	12,717
Prepaid expenses and other assets	261,465	173,565
Total assets	$ 29,087,243	19,051,944
Liabilities and Stockholders Equity		
Credit facilities on mortgage loans held for sale	$ 8,218,122	3,704,268
Financing on mortgage loans held for investment, net	18,226,819	13,105,973
Accounts payable and accrued liabilities	488,092	320,108
Convertible senior notes, net	4,931	5,392
Notes payable	45,318	37,638
Total liabilities	26,983,282	17,173,379
Commitments and contingencies		
Stockholders equity:		

Preferred stock, $0.01 par value, Authorized 10,000,000 shares; issued and outstanding 4,500,000 and zero shares at September 30, 2005 and December 31, 2004, respectively	45	
Common stock, $0.01 par value, Authorized 300,000,000 shares; issued and outstanding 56,502,453 and 54,702,623 shares at September 30, 2005 and December 31, 2004, respectively	565	547
Additional paid-in capital	1,262,969	1,108,590
Accumulated other comprehensive income (loss)	48,084	(4,700)
Retained earnings, restricted	809,006	781,627
	2,120,669	1,886,064
Deferred compensation costs	(16,708)	(7,499)
Total stockholders equity	2,103,961	1,878,565
Total liabilities and stockholders equity	$ 29,087,243	19,051,944

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(Dollars in thousands, except per share and share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Interest income	$ 494,621	264,923	1,246,553	609,186
Interest expense	(290,899)	(106,784)	(671,535)	(230,054)
Net interest income	203,722	158,139	575,018	379,132
Provision for losses on mortgage loans held for investment	(38,542)	(25,769)	(105,655)	(62,750)
Net interest income after provision for losses	165,180	132,370	469,363	316,382
Other operating income:				
Gain on sale of mortgage loans	176,241	203,390	454,697	620,417
Servicing income	10,203	7,568	23,556	21,217
Other income	4,986	2,950	12,257	3,779
Total other operating income	191,430	213,908	490,510	645,413
Operating expenses:				
Personnel	146,575	99,038	423,158	289,004
General and administrative	49,823	40,783	133,922	105,166
Advertising and promotion	25,661	16,978	66,204	46,227
Professional services	11,580	7,367	29,063	20,433
Total operating expenses	233,639	164,166	652,347	460,830
Earnings before income taxes	122,971	182,112	307,526	500,965
Income tax expense	2,867	74,833	7,583	204,064
Net earnings	120,104	107,279	299,943	296,901
Dividends on preferred stock	2,567		2,852	
Net earnings available to common stockholders	$ 117,537	107,279	297,091	296,901
Basic earnings per share	$ 2.10	3.21	5.37	8.93

Diluted earnings per share	$	2.04	2.53	5.18	7.10
Basic weighted average shares outstanding		55,870,410	33,404,837	55,345,952	33,241,323
Diluted weighted average shares outstanding		57,598,055	42,908,655	57,421,474	42,362,084

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(Dollars in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Net earnings	$ 120,104	107,279	299,943	296,901
Net unrealized gains (losses) on derivative instruments designated as hedges	66,977	(51,454)	44,371	(19,330)
Reclassification adjustment into earnings for realized losses on derivative instruments	2,375	705	9,862	
Tax effect	(600)	20,977	(1,449)	7,891
Comprehensive income	$ 188,856	77,507	352,727	285,462

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders Equity

Nine Months Ended September 30, 2005

(In thousands, except per share amounts)

	Preferred shares outstanding	Preferred stock amount	Common shares outstanding	Common stock amount	Additional paid-in capital	Accumulated Other Comprehensive Income (Loss)	Retained earnings, restricted	Deferred compensation	Total
Balance December 31, 2004		$	54,703	$ 547	1,108,590	(4,700)	781,627	(7,499)	1,878,565
Proceeds from issuance of common stock			1,744	17	24,851				24,868
Proceeds from issuance of preferred stock	4,500	45			108,619				108,664
Cancelled shares related to stock awards			(224)	(2)	(11,743)				(11,745)
Conversion of convertible senior notes			15		500				500
Issuance of restricted stock, net			264	3	14,863			(14,866)	
Amortization of deferred compensation								5,657	5,657
Net earnings							299,943		299,943
Tax benefit related to non-qualified stock options					17,289				17,289
Other comprehensive income, net of tax						52,784			52,784
Dividends declared on common stock, $4.80 per share							(269,712)		(269,712)
Dividends on preferred stock, $0.63 per share							(2,852)		(2,852)
Balance September 30, 2005 (unaudited)	4,500	$ 45	56,502	$ 565	1,262,969	48,084	809,006	(16,708)	2,103,961

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollars in thousands)

(Unaudited)

	Nine Months Ended	
	September 30, 2005	September 30, 2004
Cash flows from operating activities:		
Net earnings	$ 299,943	296,901
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	95,411	17,433
Cash flows received from residual interests	15,021	43,391
Accretion of Net Interest Receivables, or NIR	(11,949)	(18,629)
NIR gains/discounts	36,106	(35,375)
Initial deposits to over-collateralization accounts	(70,913)	(20,040)
Retained bond		(3,510)
Servicing gains	(60,927)	(4,508)
Fair value adjustment of residual securities	7,645	6,361
Provision for losses on mortgage loans held for investment	105,655	62,750
Provision for repurchase losses	8,098	3,722
Mortgage loans originated or acquired for sale	(30,215,340)	(23,072,756)
Mortgage loan sales, net	25,453,537	22,464,159
Principal payments on mortgage loans held for sale	209,084	93,553
Increase in credit facilities on mortgage loans held for sale	4,513,854	510,371
Tax benefit related to non-qualified stock options	17,289	
Net change in other assets and liabilities	39,746	(74,708)
Net cash provided by operating activities	442,260	269,115
Cash flows from investing activities:		
Mortgage loans originated or acquired for investment, net	(10,273,642)	(7,622,891)
Principal payments on mortgage loans held for investment	4,984,710	1,442,366
Purchases of office property and equipment	(46,761)	(20,020)
Acquisition of net assets	(80,573)	
Sale of mortgage servicing rights	8,477	15,184
Net cash used in investing activities	(5,407,789)	(6,185,361)
Cash flows from financing activities:		
Proceeds from issuance of financing on mortgage loans held for investment, net	9,792,230	7,410,872
Repayments of financing on mortgage loans held for investment	(4,688,033)	(1,365,980)

Proceeds from issuance of preferred stock	108,664	
Proceeds from notes payable	23,097	22,769
Repayment of notes payable	(15,417)	(10,485)
Change in restricted cash	(317,306)	(242,468)
Payment of dividends on common stock	(259,067)	(18,930)
Payment of dividends on preferred stock	(2,852)	
Net proceeds from issuance of stock	25,368	7,968
Purchase of common stock	(13,950)	
Net cash provided by financing activities	4,652,734	5,803,746
Net decrease in cash and cash equivalents	(312,795)	(112,500)
Cash and cash equivalents, beginning of period	842,854	278,598
Cash and cash equivalents, end of period	$ 530,059	166,098
Supplemental cash flow disclosure:		
Interest paid	$ 280,871	217,811
Income taxes paid (refunded)	(72,509)	284,595
Supplemental non-cash financing activity:		
Restricted stock issued	14,866	5,782
Accrued dividends	93,183	7,838

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

(Unaudited)

September 30, 2005 and 2004

1. Basis of Presentation

New Century TRS Holdings, Inc. (formerly known as New Century Financial Corporation), a Delaware corporation (New Century TRS), was incorporated on November 17, 1995. New Century Mortgage Corporation, a wholly-owned subsidiary of New Century TRS (New Century Mortgage), commenced operations in February 1996 and is a mortgage finance company engaged in the business of originating, purchasing, selling and servicing mortgage loans secured primarily by first and second mortgages on single-family residences. NC Capital Corporation, a wholly-owned subsidiary of New Century Mortgage (NC Capital), was formed in December 1998 to conduct the secondary marketing activities of New Century (as defined below). New Century Credit Corporation (formerly known as Worth Funding Incorporated), a wholly-owned subsidiary of New Century (New Century Credit), was acquired in March 2000 by New Century Mortgage. NC Residual IV Corporation, a wholly-owned subsidiary of New Century (NCRIV), was formed in September 2004 to hold a portfolio of mortgage loans held for investment. After consummation of the Merger (defined below), New Century purchased New Century Credit from New Century Mortgage. The terms New Century, Company, we, our, and us refer to New Century Financial Corporation, except where the context otherwise requires.

On April 5, 2004, New Century TRS s board of directors approved a plan to change New Century TRS s capital structure to enable it to qualify as a real estate investment trust, or REIT, for United States federal income tax purposes. The decision to convert to a REIT was based on several factors, including the potential for increased stockholder return, tax efficiency and ability to achieve growth objectives. On April 19, 2004, New Century TRS s board of directors approved certain legal and financial matters related to the proposed REIT conversion.

On April 12, 2004, New Century TRS formed New Century Financial Corporation (formerly known as New Century REIT, Inc.), a Maryland corporation (New Century). On September 15, 2004, New Century TRS s stockholders approved and adopted the Agreement and Plan of Merger dated as of April 21, 2004 (the Merger Agreement), by and among New Century TRS, New Century and NC Merger Sub, Inc., a Delaware corporation formed by New Century for purposes of effecting the Merger (Merger Sub), which implemented the restructuring of New Century TRS in order for it to qualify as a REIT (the Merger).

Pursuant to the Merger Agreement, (i) Merger Sub merged with and into New Century TRS, with New Century TRS as the surviving corporation, (ii) each outstanding share of New Century TRS s common stock was converted into the right to receive one share of common stock, par value of $0.01 per share, of New Century, (iii) New Century TRS became a wholly-owned subsidiary of New Century and changed its name from New Century Financial Corporation to New Century TRS Holdings, Inc., and (iv) New Century REIT, Inc. changed its name to New Century Financial Corporation. The Merger was consummated and became effective on October 1, 2004, and was accounted for on an as if pooling basis. These condensed consolidated financial statements give retroactive effect to the Merger for the periods presented. Accordingly, under as if pooling accounting, the assets and liabilities of New Century TRS transferred to New Century in connection with the Merger have been accounted for at historical amounts as if New Century TRS was transferred to New Century as of the earliest date presented and the condensed consolidated financial statements of New Century prior to the Merger include the results of operations of New Century TRS. Stockholders equity amounts presented for years prior to the formation of New Century are those of New Century TRS, adjusted for the Merger exchange rate.

On September 29, 2004, in contemplation of the Merger, New Century TRS requested that The Nasdaq Stock Market, Inc. suspend the listing of the shares of New Century TRS s common stock on the Nasdaq National Market prior to the commencement of trading on October 1, 2004. Shares of New Century s common stock, which were issued in exchange for then outstanding shares of New Century TRS common stock on a one-for-one basis in connection with the Merger, were approved for listing on the New York Stock Exchange, Inc. and commenced trading on October 1, 2004 under the ticker symbol NEW.

On September 2, 2005, Home123 Corporation, an indirect wholly-owned subsidiary of the Company (Home123), purchased certain assets and assumed certain related liabilities of RBC Mortgage Company, or RBC Mortgage. Such net assets are primarily related to the RBC Mortgage origination platform. The Company expects that the acquisition will enable it to expand its mortgage product offerings to include conventional mortgage loans, loans insured by the Federal Housing Administration and loans guaranteed by the Veterans Administration, its retail presence on a nationwide basis and its channels of distribution.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

September 30, 2005 and 2004

The purchase price for the net assets was $80.6 million, and was accounted for using the purchase method. Of the aggregate amount, $7.6 million was the fair value of assets acquired and $4.7 million was the fair value of liabilities assumed. The excess of the purchase price over the fair values of assets acquired and liabilities assumed was allocated to goodwill. Goodwill of $77.7 million was recorded at Home123. The initial purchase price allocations may be adjusted within one year of the purchase date for changes in estimates of the fair value of assets acquired and liabilities assumed.

The notes to the financial statements, where applicable, discuss the results of operations of the origination platform acquired by the Company from RBC Mortgage in September 2005. Where the results are discussed, newly-acquired operations refer to the operations of the origination platform acquired from RBC Mortgage and historical operations refer to the operations of New Century that existed prior to the RBC Mortgage transaction.

The accompanying condensed consolidated financial statements include the consolidated financial statements of the Company s wholly-owned subsidiaries, New Century TRS, New Century Credit, NCRIV and Home123. All material intercompany balances and transactions are eliminated in consolidation.

The Company has prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further information, refer to the consolidated financial statements and notes thereto included in New Century s Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission.

Reclassification

Certain amounts from the prior year s presentation have been reclassified to conform to the current year s presentation.

Recent Accounting Developments

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 2003 except for mandatory redeemable financial instruments of nonpublic entities. The Company applied the provisions of SFAS 150 when the Company s 9.125% Series A Cumulative Redeemable Preferred Stock was issued in the second quarter of 2005.

On December 16, 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which replaces Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123), and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Securities and Exchange Commission (SEC) registrants originally would have been required to adopt SFAS 123R s provisions at the beginning of their first interim period after June 15, 2005. On April 14, 2005, the SEC announced that registrants could delay adoption of SFAS 123R s provisions until the beginning of their next fiscal year. The Company currently expects to adopt SFAS 123R on January 1, 2006, using the modified prospective transition method. The scope of SFAS 123R includes a wide range of stock-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. SFAS 123R will require the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date. That cost must be recognized in the income statement over the vesting period of the award. Under the modified prospective transition method, awards that are granted, modified or settled beginning at the date of adoption will be measured and accounted for in accordance with SFAS 123R. In addition, expense must be recognized in the statement of income for unvested awards that were granted prior to the date of adoption. The expense will be based on the fair value determined at the grant date.

The notes to financial statements disclose information to assist users of financial information to understand the nature of share-based payment transactions and the effects of those transactions on the financial statements. The Company currently provides pro forma disclosure as to the impact of SFAS 123 or SFAS 123R in footnote 1 of the Notes to Condensed Consolidated Financial Statements Stock-Based Compensation.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

September 30, 2005 and 2004

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash equivalents consist of cash on hand and due from banks.

Restricted Cash

As of September 30, 2005, restricted cash totaled $771.3 million, and included $57.0 million in cash held in a margin account associated with the Company s interest rate risk management activities, $694.2 million in cash held in custodial accounts associated with its mortgage loans held for investment, $20.0 million in cash held in a cash reserve account in connection with its asset-backed commercial paper facility, and $166,000 in cash held in trust accounts on behalf of borrowers. As of December 31, 2004, restricted cash totaled $454.0 million, and included $58.2 million in cash held in a margin account associated with its interest rate risk management activities, $375.8 million in cash held in custodial accounts associated with its mortgage loans held for investment, and $20.0 million in cash held in a cash reserve account in connection with its asset-backed commercial paper facility.

Mortgage Loans Held for Sale

Mortgage loans held for sale are stated at the lower of amortized cost or fair value as determined by outstanding commitments from investors or current investor-yield requirements, calculated on an aggregate basis.

Mortgage Loans Held for Investment

Mortgage loans held for investment represent loans securitized through transactions structured as financings, or pending securitization through transactions that are expected to be structured as financings. Mortgage loans held for investment are stated at amortized cost, including the outstanding principal balance, less the allowance for loan losses, plus net deferred origination costs. The financing related to these securitizations is included in the Company s condensed consolidated balance sheet as financing on mortgage loans held for investment.

Allowance for Losses on Mortgage Loans Held for Investment

In connection with its mortgage loans held for investment, the Company establishes an allowance for loan losses based on its estimate of losses inherent and probable as of its balance sheet date. The Company charges off uncollectible loans at the time of liquidation. The Company evaluates the adequacy of this allowance each quarter, giving consideration to factors such as the current performance of the loans, characteristics of the portfolio, the value of the underlying collateral and the general economic environment. In order to estimate an appropriate allowance for losses for loans held for investment, the Company estimates losses using static pooling, which stratifies the loans held for investment into separately identified vintage pools. Provision for losses is charged to the Company s condensed consolidated statement of earnings. Losses incurred are charged to the allowance. Management considers the current allowance to be adequate.

Residual Interests in Securitizations

Residual interests in securitizations, or Residuals, are recorded as a result of the sale of loans through securitizations that the Company structures as sales rather than financings, referred to as off-balance sheet securitizations. The Company may also sell Residuals through what are sometimes referred to as net interest margin securities, or NIMS.

In a securitization structured as a sale, the Company sells a pool of loans to a trust for a cash purchase price and a certificate evidencing its residual interest ownership in the trust. The trust raises the cash portion of the purchase price by selling senior certificates representing senior interests in the loans in the trust. Following the securitization, purchasers of senior certificates receive the principal collected, including prepayments, on the loans in the trust. In addition, they receive a portion of the interest on the loans in the trust equal to the specified investor pass-through interest rate on the principal balance. The Company receives the cash flows from the Residuals after payment of servicing fees, guarantor fees and other trust expenses if the specified over-collateralization requirements are met. Over-collateralization requirements are generally based on a percentage of the original or current unpaid principal balance of the loans and may be increased during the life of the transaction depending upon actual delinquency or loss experience. A NIMS transaction, through which certificates are sold that represent a portion of the spread between the coupon rate on the loans and the investor pass-through interest rate, may also occur

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concurrently with or shortly after a securitization. A NIMS transaction allows the Company to receive a substantial portion of the gain in cash at the closing of the NIMS transaction, rather than over the actual life of the loans.

The Annual Percentage Rate, or APR, on the mortgage loans is relatively high in comparison to the investor pass-through interest 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 estimates the future rate of prepayments, prepayment penalties that it will receive, delinquencies, defaults and default loss severity as they affect the amount and timing of the estimated cash flows. The Company estimates average cumulative losses as a percentage of the original principal balance of the mortgage loans of 1.68% to 4.71% for adjustable-rate securities and 1.45% to 5.22% for fixed-rate securities. The estimated cumulative losses of the two securitizations completed in 2005 was 2.7%. The Company bases these estimates on historical loss data for the loans, the specific characteristics of the loans, and the general economic environment. While the range of estimated cumulative pool losses is fairly broad, the weighted average cumulative pool loss estimate for the entire portfolio of residual assets was 3.76% at September 30, 2005. The Company estimates prepayments by evaluating historical prepayment performance of its loans and the impact of current trends. The Company uses 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). These prepayment curve and default estimates have resulted in weighted average lives of between 2.26 to 2.58 years for the Company s adjustable-rate securities and 2.38 to 3.47 years for its fixed-rate securities. The estimated weighted average life of the two securitizations completed in 2005 was 2.56 years.

During the nine months ended September 30, 2005, the Company completed two securitizations structured as sales totaling $3.0 billion. The gain on sale recorded for the two securitizations was $71.6 million and the Company s retained interests totaled $34.8 million.

During the nine months ended September 30, 2005, the Residuals provided $15.0 million in net cash flow to the Company. The Company performs an evaluation of the Residuals quarterly, taking into consideration trends in actual cash flow performance, industry and economic developments, as well as other relevant factors. During the quarter ended September 30, 2005, the Company increased its prepayment rate assumptions based upon actual performance and made minor adjustments to certain other assumptions, resulting in a $3.2 million decrease in the fair value for the quarter that is recorded as a reduction to gain on sale of mortgage loans.

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.

The Company is party to various transactions that have an off-balance sheet component. In connection with the Company s off-balance sheet securitization transactions, as of September 30, 2005, there were $3.7 billion in loans owned by the off-balance sheet trusts. The trusts have issued bonds secured by these loans. The bondholders generally do not have recourse to the Company in the event that the loans in the various trusts do not perform as expected. Because these trusts are qualifying special purpose entities, in accordance with generally accepted accounting principles, the Company has included only its residual interest in these loans on its condensed consolidated balance sheet. The performance of the loans in the trusts will impact the Company s ability to realize the current estimated fair value of these residual assets.

Derivative Instruments Designated as Hedges

The Company accounts for certain Euro Dollar futures and interest rate cap contracts designated and documented as cash flow hedges pursuant to the requirements of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). Pursuant to SFAS 133, these contracts have been designated as hedging the exposure to variability of cash flows from the Company s variable rate financing on mortgage loans held for investment attributable to changes in interest rates. Cash flow hedge accounting requires that the effective portion of the gain or loss in the fair value of a derivative instrument designated as a hedge be reported in other comprehensive income and the ineffective portion be reported in current earnings. Additionally, certain Euro Dollar futures contracts were designated as hedges of the fair values of certain mortgage loans held for investment and certain mortgage loans held for sale pursuant to SFAS 133. Fair value hedge accounting requires that for a fair value hedge, changes in the fair value of the derivative instrument and changes in the fair value of the hedged asset or liability attributable to the hedged risk be reported in current earnings.

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Comprehensive income

Comprehensive income includes unrealized gains and losses that are excluded from the Company s consolidated statement of earnings and are reported as a separate component in stockholders equity as accumulated other comprehensive income (loss). The unrealized gains and losses include unrealized gains and losses on the effective portion of cash flow hedges.

The following table presents a summary of the activity for the accumulated other comprehensive income (loss) for the nine months ended September 30, 2005 (dollars in thousands):

Balance, beginning of period	$ (4,700)
Net unrealized gain on derivative instruments designated as hedges	44,371
Reclassification adjustment into earnings for realized loss on derivative instruments	9,862
Tax effect	(1,449)
Balance, end of period	$ 48,084

Income Taxes

The Company is a REIT for federal income tax purposes and is not generally required to pay federal and most state income taxes if it meets the REIT requirements of the Internal Revenue Code of 1986, as amended, or the Code. Also, each of the Company s subsidiaries that meet the requirements of the Code to be a qualified REIT subsidiary, or a QRS, are not generally required to pay federal and most state income taxes. However, the Company must recognize income taxes in accordance with Statement of Financial Accounting Standards No. 109 Accounting for Income Taxes, (SFAS 109) for each of its taxable REIT subsidiaries, or TRS, whose income is fully taxable at regular corporate rates.

SFAS 109 requires that inter-period income tax allocation be based on the asset and liability method. Accordingly, the Company recognizes the tax effects of temporary differences between its tax and financial reporting bases of assets and liabilities that will result in taxable or deductible amounts in future periods.

Stock-Based Compensation

The Company has elected to follow APB 25 and related interpretations in accounting for employee stock options rather than the fair value accounting allowed by SFAS 123. APB 25 provides that compensation expense relative to the Company s employee stock options is recorded over the vesting period if the current market price of the underlying stock exceeds the exercise price on the date of grant. Under SFAS 123, the fair value of stock options at the date of grant is recognized in earnings over the vesting period of the options. In December 2002, FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148), which amends SFAS 123 to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent

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disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method on reported results.

The fair value of each stock option granted is estimated at the date of grant using the Black-Scholes option-pricing model. The weighted average fair value of stock options granted and the weighted average underlying assumptions used to estimate those values for the three and nine months ended September 30, 2005 and 2004 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Fair value	$ 10.87	26.21	9.23	19.66
Expected life (years)	4.5	4.5	4.5	4.5
Risk-free interest rate	3.9%	3.4	4.2	3.3
Volatility	59.4%	59.5	60.5	52.8
Expected annual dividend yield	12.5%	1.6	13.7	1.8

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As of September 30, 2005 and 2004, there were stock options outstanding for the purchase of 3,998,657 and 5,352,422 shares, respectively, of the Company s common stock. The following table shows the pro forma net income as if the fair value method of SFAS 123 had been used to account for stock-based compensation expense (dollars in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic net earnings available to common shareholders:				
As reported	$ 117,537	107,279	297,091	296,901
Compensation expense, net of related tax effects	(1,782)	(1,562)	(4,971)	(4,066)
Pro forma	$ 115,755	105,717	292,120	292,835
Diluted net earnings available to common shareholders:				
As reported	$ 117,507	108,576	297,156	300,705
Compensation expense, net of related tax effects	(1,782)	(1,562)	(4,971)	(4,066)
Pro forma	$ 115,725	107,014	292,185	296,639
Basic earnings per share:				
As reported	$ 2.10	3.21	5.37	8.93
Pro forma	2.07	3.16	5.28	8.81
Diluted earnings per share:				
As reported	$ 2.04	2.53	5.18	7.10
Pro forma	2.03	2.53	5.15	7.10
Basic weighted average shares outstanding:				
As reported	55,870	33,405	55,346	33,241
Pro forma	55,870	33,405	55,346	33,241
Diluted weighted average shares outstanding:				
As reported	57,598	42,909	57,421	42,362
Pro forma	56,909	42,241	56,747	41,754

2. Mortgage Loans Held for Sale

A summary of mortgage loans held for sale, at the lower of cost or market at September 30, 2005 and December 31, 2004, is as follows (dollars in thousands):

	September 30, 2005	December 31, 2004
First trust deeds	$ 7,881,625	3,677,255
Second trust deeds	643,228	197,362
Net deferred origination costs and other	46,009	48,248
	$ 8,570,862	3,922,865

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At September 30, 2005, the Company had mortgage loans held for sale of approximately $58.6 million on which the accrual of interest had been discontinued. If these mortgage loans had been current throughout their terms, interest income would have increased by approximately $2.8 million for the nine months ended September 30, 2005.

3. Mortgage Loans Held for Investment

For the three and nine months ended September 30, 2005, the Company securitized $2.1 billion and $11.0 billion in loans, respectively, through transactions structured as financings, resulting in an increase in its mortgage loans held for investment. As of September 30, 2005, the balance of mortgage loans held for investment included $30.8 million of mortgage loans held for investment that were not yet securitized. A summary of the components of mortgage loans held for investment at September 30, 2005 and December 31, 2004 is as follows (dollars in thousands):

	September 30, 2005	December 31, 2004
Mortgage loans held for investment:		
Unpaid principal balance of mortgage loans	$ 18,358,892	13,169,595
Allowance for loan losses	(177,759)	(90,227)
Net deferred origination costs	149,180	115,956
	$ 18,330,313	13,195,324

At September 30, 2005, the Company had mortgage loans held for investment of approximately $479.2 million on which the accrual of interest had been discontinued. If these mortgage loans had been current throughout their terms, interest income would have increased by approximately $20.0 million for the nine months ended September 30, 2005.

The following table presents a summary of the activity for the allowance for losses on mortgage loans held for investment for the three and nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Beginning balance	$ 145,565	61,307	90,227	26,251
Additions	38,542	25,769	105,655	62,750
Charge-offs	(6,348)	(2,420)	(18,123)	(4,345)
	$ 177,759	84,656	177,759	84,656

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4. Residual Interests in Securitizations

Residual interests in securitizations consisted of the following components at September 30, 2005 and December 31, 2004 (dollars in thousands):

	September 30, 2005	December 31, 2004
Over-collateralization account	$ 220,859	158,755
Net interest receivable (NIR)	(48,748)	(10,734)
	$ 172,111	148,021

Residual interests in securitizations are recorded at estimated fair value, which is based on estimated discounted cash flows. The over-collateralization account in the table above represents the current, un-discounted balance of the over-collateralization accounts at period end. The net interest receivable, or NIR, balance represents the difference between the estimated discounted cash flows less the un-discounted value of the over-collateralization accounts, resulting in the presentation above.

The following table summarizes the activity in the over-collateralization, or OC, accounts for the nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Nine Months Ended September 30,	
	2005	2004
Balance, beginning of period	$ 158,755	169,905

Initial deposits to OC accounts	70,913	
Additional deposits to OC accounts	1,834	20,880
Release of cash from OC accounts	(10,643)	(10,052)
Balance, end of period	$ 220,859	180,733

The following table summarizes activity in the NIR accounts for the nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Nine Months Ended September 30,	
	2005	**2004**
Balance, beginning of period	$ (10,734)	9,593
NIR gains (discounts)	(36,106)	35,375
Cash received from NIRs	(6,212)	(34,179)
Accretion of NIRs	11,949	18,629
Fair value adjustment	(7,645)	(6,361)
Balance, end of period	$ (48,748)	23,057

During the nine months ended September 30, 2005, the Company completed two securitizations structured as sales totaling $3.0 billion. During the nine months ended September 30, 2004, the Company completed two securitizations structured as sales, related to its investment in Carrington Mortgage Credit Fund I, LP (Carrington). Purchasers of securitization bonds

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and certificates have no recourse against the other assets of the Company, other than the assets of the trust. The value of the Company s retained interests is subject to credit, prepayment and interest rate risk on the transferred financial assets.

5. Mortgage Servicing Assets

Mortgage servicing assets represent the estimated fair value of our mortgage loan servicing rights. The following table summarizes activity in the mortgage servicing assets for the nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Nine Months Ended September 30,	
	2005	**2004**
Balance, beginning of period	$ 8,249	1,900
Additions	60,927	4,508
Sales of servicing rights	(8,477)	
Amortization	(6,389)	(1,113)
Balance, end of period	$ 54,310	5,295

The Company records mortgage servicing assets when it sells loans on a servicing-retained basis and when it sells loans through whole loan sales to an investor in the current period and sells the servicing rights to a third party in a subsequent period.

The addition of $60.9 million for the nine months ended September 30, 2005 includes: (i) $35.8 million of servicing rights retained by the Company in certain of its whole loan sales to Carrington, (ii) $8.7 million of servicing rights related to the securitization structured as a sale completed in June 2005 (which was subsequently sold to a third party in August 2005 for $8.5 million) and (iii) $16.4 million of servicing rights related to the securitization structured as a sale completed in September 2005 (which will be sold to a third party in November 2005 for $16.4 million).

6. Goodwill

Goodwill is recorded in connection with the acquisition of new subsidiaries or net assets and is included in prepaid expenses and other assets. As of September 30, 2005 and December 31, 2004, the Company had goodwill of $93.2 million and $12.7 million, respectively. No impairment was recognized during the nine months ended September 30, 2005.

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7. Credit Facilities and Other Short-Term Borrowings

Credit facilities and other short-term borrowings consist of the following at September 30, 2005 and December 31, 2004 (dollars in thousands):

	September 30, 2005	December 31, 2004
A $2.0 billion asset-backed commercial paper facility for Von Karman Funding LLC, a wholly-owned subsidiary of New Century Mortgage, expiring in September 2006, secured by mortgage loans held for sale and cash generated through the sale of loans, bearing interest based on a margin over one-month LIBOR.	$	
A $2.0 billion master repurchase agreement ($1 billion of which is uncommitted) among New Century Mortgage, NC Capital, NC Residual II, New Century Credit and Bank of America, N.A. expiring in September 2006, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	1,089,106	975,119
A $1.0 billion master repurchase agreement among New Century Mortgage, Home 123 and Bank of America expiring in September 2006, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	76,504	
A $1.0 billion master repurchase agreement among New Century Credit, NC Residual II Corporation, a wholly-owned subsidiary of NC Capital (NC Residual II), New Century Mortgage, NC Capital and Barclays Bank PLC expiring in November 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR. This facility was temporarily increased to $2.0 billion until October 2005. The Company expects to either renew or extend this facility prior to its expiration.	1,399,878	43,917
An $800 million aggregation uncommitted facility from Bear Stearns Mortgage Capital Corporation expiring in November 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR. The Company expects to either renew or extend this facility prior to its expiration.	358,471	428,397
An $850 million master repurchase agreement among New Century Credit, New Century Mortgage, NC Capital, NC Residual II, Home123 and IXIS Real Estate Capital Inc. expiring in October 2006, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	605,338	617,141

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	September 30, 2005	December 31, 2004
A $150 million master repurchase agreement between New Century Funding SB-1, a Delaware business trust and wholly-owned subsidiary of New Century Mortgage, and Citigroup Global Markets Reality Corp., successor to Salomon Brothers Reality Corp., expiring in December 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR. The Company expects to either renew or extend this facility prior to its expiration.		
A $650 million repurchase agreement among New Century Credit, NC Capital and Citigroup Global Markets expiring in December 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR. The Company has the ability to increase the size of this facility to $800 million provided that the value of the loans outstanding at any one time under this facility and the $150 million facility set forth immediately above may not exceed $800 million in the aggregate. The Company expects to renew or extend the termination date for this facility prior to its expiration.	556,124	260,025
A $150 million master loan and security agreement among New Century Mortgage, NC Capital, New Century and Citigroup Global Markets expiring in December 2005, secured by delinquent loans and REO properties, bearing interest based on a margin over one-month LIBOR. The Company expects to either renew or extend this facility prior to its expiration.	74,919	959
A $250 million repurchase agreement between New Century Mortgage and Citigroup Global Markets expiring in December 2005, secured by small balance commercial mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	43,658	54,398
A $1.0 billion master loan and security agreement among New Century Credit, New Century Mortgage, NC Capital, Home123 and Credit Suisse First Boston Mortgage Capital LLC expiring in November 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR. The Company expects to renew or extend this facility prior to its expiration.	665,797	
A $1.0 billion master repurchase agreement among New Century Credit, New Century Mortgage, NC Capital, Home123 and Deutsche Bank Securities Inc. expiring in September 2006, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	489,183	

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	September 30, 2005	December 31, 2004
A $2.0 billion master loan and security agreement among New Century Credit, New Century Mortgage, NC Capital, NC Residual II, Morgan Stanley Bank, Concord Minutemen Capital Company, LLC and Morgan Stanley Mortgage Capital Inc. expiring in February 2007, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	1,110,629	959,822
A $2.0 billion asset-backed note purchase and security agreement ($500 million of which is uncommitted) between New Century Funding I, a special-purpose vehicle established as a Delaware statutory trust, which is a wholly-owned subsidiary of New Century Mortgage, and UBS Real Estate Securities Inc. expiring in June 2006, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	1,763,745	1,141,167
Less: Credit facility amounts reclassified to financing on mortgage loans held for investment	(15,230)	(776,677)
	$ 8,218,122	3,704,268

The various credit facilities contain certain restrictive financial and other covenants that require the Company to, among other things, restrict dividends, maintain certain levels of net worth, liquidity, available borrowing capacity and debt-to-net worth ratios and comply with regulatory and investor requirements. The Company was in compliance with these covenants at September 30, 2005.

8. Financing on Mortgage Loans Held for Investment

When the Company sells loans through securitizations structured as financings, the related bonds are added to its balance sheet. As of September 30, 2005 and December 31, 2004, the financing on mortgage loans held for investment consisted of the following (dollars in thousands):

	September 30, 2005	December 31, 2004

Securitized bonds	$ 18,254,838	12,379,524
Short-term financing on retained bonds	4,884	23,616
2003-NC5 NIM bond		7,583
2005-NC3 NIM bond	22,827	
Debt issuance costs	(70,960)	(81,427)
Credit facility amounts reclassified from warehouse credit facilities	15,230	776,677
Total financing on mortgage loans held for investment	$ 18,226,819	13,105,973

The Company s maturity of financing on mortgage loans held for investment is based on certain prepayment assumptions. The Company estimates the average life of its various securitized loan pools to be between 1.8 and 3.9 years. The following table

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reflects the estimated maturity of the financing on mortgage loans held for investment as of September 30, 2005 (dollars in thousands):

Due in less than 1 year	$ 5,298,181
Due in 2 years	5,254,780
Due in 3 years	2,259,611
Thereafter	5,414,247
	$ 18,226,819

9. Convertible Senior Notes Private Offering

On July 8, 2003, New Century TRS closed a private offering of $175.0 million of convertible senior notes due July 3, 2008 pursuant to Rule 144A under the Securities Act of 1933. On July 14, 2003, the initial purchasers of the convertible senior notes exercised their option, in full, to acquire an additional $35.0 million principal amount of the convertible senior notes. The convertible senior notes bear interest at a rate of 3.50% per year, paid semi-annually, and, as of March 17, 2004, became convertible into New Century TRS common stock at a conversion price of $34.80 per share. The conversion price represents a 28.0% premium over the closing share price on July 8, 2003. Principal balance is not due until maturity. As a result of the Merger, the convertible senior notes became convertible into shares of New Century common stock. On February 14, 2005, New Century, New Century TRS and the trustee under the indenture governing the convertible senior notes entered into a second supplemental indenture pursuant to which New Century agreed to fully and unconditionally guarantee the due and punctual payment of the convertible senior notes.

On November 22, 2004, New Century TRS commenced an offer, upon the terms and subject to the conditions described in the prospectus related to the offer and the accompanying letter of transmittal, to convert all the outstanding convertible senior notes into shares of New Century common stock, cash, or a combination of both. The offer and withdrawal rights expired at midnight, New York City time, on December 23, 2004. On December 24, 2004, New Century TRS accepted for payment $204.5 million, or approximately 97.4%, of the $210.0 million aggregate principal amount of the convertible senior notes then outstanding, which constituted all of the convertible senior notes validly tendered and not withdrawn. In the aggregate, the holders who tendered their convertible senior notes for conversion in the offer received 6,236,431 shares of New Century common stock, which included 359,796 shares for additional consideration and an additional $3.4 million in cash for accrued interest through that date. On June 27, 2005, a holder of New Century TRS s convertible senior notes proposed, and the Company agreed, to convert $500,000 principal amount of convertible senior notes into 15,014 shares of its common stock. In connection with the conversion, the Company made a cash payment to the holder of $51,104, which included a conversion incentive fee and accrued interest through that date.

As of September 30, 2005, the number of shares of New Century s common stock into which the remaining convertible senior notes were convertible was 154,679, subject to certain adjustments under the terms of the convertible senior notes. For example, the terms of the convertible senior notes allow for the conversion rate to adjust if the Company s dividend rate increases generally above a dividend yield of 1.75%, subject to certain other factors. As of September 30, 2005, the maximum number of shares of New Century s common stock into which the remaining untendered convertible senior notes were convertible was 176,637, subject to certain adjustments under the terms of the convertible senior notes. On October 31, 2005, concurrent with the payment of a cash dividend of $1.65 per share, the number of shares into which the remaining convertible senior notes were convertible was adjusted to 159,009.

10. Series A Cumulative Redeemable Preferred Stock Offering

In June 2005, the Company sold 4,500,000 shares of its Series A Cumulative Redeemable Preferred Stock, including 300,000 shares to cover overallotments. The offering provided $108.7 million in net proceeds. The shares have a liquidation value of $25.00 per share and pay an annual coupon of 9.125% and are not convertible into any other securities. The Company may, at its option, redeem the Series A Cumulative Redeemable Preferred Stock, in the aggregate or in part, at any time on or after June 21, 2010. As such, this stock is not considered mandatorily or contingently redeemable under the

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provisions of SFAS 150 and is therefore classified as a component of equity. The Company paid preferred stock dividends for the second and third quarters on September 30, 2005, and, as a result, accrued preferred stock dividends were zero as of September 30, 2005.

11. Interest Income

The following table presents the components of interest income for the three and nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Interest on mortgage loans held for investment	$ 342,105	148,308	905,652	325,117
Interest on mortgage loans held for sale - Historical	144,440	112,382	319,470	270,445
Interest on mortgage loans held for sale - Newly-acquired	1,436		1,436	
Residual interest income	4,022	4,193	11,949	13,551
Other interest income	2,618	40	8,046	73
	$ 494,621	264,923	1,246,553	609,186

12. Interest Expense

The following table presents the components of interest expense for the three and nine months ended September 30, 2005 and 2004 (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Interest on financing on mortgage loans held for investment	$ 196,376	62,347	474,742	128,762
Interest on credit facilities and other short-term borrowings - Historical	84,815	41,013	181,871	90,699
Interest on credit facilities and other short-term borrowings - Newly-acquired	1,115		1,115	
Interest on convertible senior notes	67	2,126	190	6,376
Other interest expense	8,526	1,298	13,617	4,217
	$ 290,899	106,784	671,535	230,054

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13. Hedging Activities

In connection with the Company s strategy to mitigate interest rate risk on its residual assets, mortgage loans held for sale and mortgage loans held for investment, the Company uses derivative financial instruments such as Euro Dollar futures and interest rate cap contracts. It is not the Company s policy to use derivatives to speculate on interest rates. These derivative instruments have an active secondary market, and are intended to provide income and cash flow to offset potential reduced interest income and cash flow under certain interest rate environments, as well as to hedge the fair value of certain fixed-rate mortgage loans held for investment and certain mortgage loans held for sale. In accordance with SFAS 133, the derivative financial instruments and any related margin accounts are reported on the condensed consolidated balance sheets at their fair value.

In 2003, the Company began applying hedge accounting as defined by SFAS 133 for certain derivative financial instruments used to hedge cash flows related to its financing on mortgage loans held for investment. In June 2004, the Company began applying hedge accounting for certain derivative financial instruments to hedge the fair value of certain of its mortgage loans held for investment and certain of its mortgage loans held for sale. The Company designates certain derivative financial instruments, Euro Dollar futures and interest rate cap contracts as hedge instruments under SFAS 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented.

The Company documents the relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions. This process includes linking derivatives to specific assets and liabilities on the condensed consolidated balance sheet. The Company also assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives used in hedging transactions are highly effective in offsetting changes in cash flows or fair value of the hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company will discontinue hedge accounting prospectively.

When hedge accounting is discontinued because the Company determines that the derivative no longer qualifies as an effective hedge, the derivative will continue to be recorded on the condensed consolidated balance sheet at its fair value. Any change in the fair value of a derivative no longer qualifying as an effective hedge is recognized in current period earnings. When a hedge is terminated, it is derecognized at the time of termination. For terminated cash flow hedges or cash flow hedges that no longer qualify as effective, the effective position previously recorded is recorded in earnings when the hedged item affects earnings.

Cash Flow Hedge Instruments - For derivative financial instruments designated as cash flow hedge instruments, the Company evaluates the effectiveness of these hedges against the variable rate interest payments related to its financing on mortgage loans held for investment being hedged to ensure there remains a highly effective correlation in the hedge relationship. To hedge the adverse effect of interest rate changes on the cash flows as a result of changes in the benchmark LIBOR interest rate, which affect the interest payments related to its financing on mortgage loans held for investment (variable rate debt) being hedged, the Company uses derivatives classified as cash flow hedges under SFAS 133. Once the hedge relationship is established, for those derivative instruments designated as qualifying cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income during the current period, and reclassified into earnings in the period(s) during which the hedged transaction affects earnings pursuant to SFAS 133. The ineffective portion and/or remaining gain or loss on the derivative instrument is recognized in earnings in the current period. During the three and nine months ended September 30, 2005, the Company recognized a gain of $2.2 million and $5.8 million, respectively, from the ineffective portion of these hedges. For the three and nine months ended September 30, 2004, the Company recorded a charge to earnings of approximately $0.7 million and zero, respectively, for the ineffective portion of these hedges.

As of September 30, 2005, the Company had open Euro Dollar futures contracts that were designated as hedging the variability in expected cash flows from the variable rate debt related to its financing on mortgage loans held for investment. The fair value of these contracts at September 30, 2005 was a $79.5 million asset and is included in prepaid expenses and other assets. The fair value of these contracts at September 30, 2004 was a $21.5 million liability, and is included in accounts payable and accrued liabilities. For the three and nine months ended September 30, 2005, the Company recognized a gain of $11.3 million and $31.9 million, respectively, attributable to cash flow hedges, which has been recorded as a reduction of interest expense related to the Company s financing on mortgage loans held for investment. Additionally, certain Euro Dollar futures contracts were terminated during the fourth quarter of 2004 in connection with the transfer of certain assets from New Century TRS to New Century. The fair value of the contracts at the termination date of ($30.9) million is being amortized from other comprehensive income over the original hedge period, as the hedged transaction affects future earnings. The

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amortization of $3.2 million and $9.3 million, respectively, for the three and nine months ended September 30, 2005 have been recorded as an increase in interest expense related to the Company s financing on mortgage loans held for investment. As of September 30, 2005, the related other comprehensive income balance was ($21.6) million.

Fair Value Hedge Instruments - For derivative financial instruments designated as fair value hedge instruments, the Company evaluates the effectiveness of these hedges against the fair value of the asset being hedged to ensure that there remains a highly effective correlation in the hedge relationship. To hedge the adverse effect of interest rate changes on the fair value of the hedged assets as a result of changes in the benchmark LIBOR interest rate, the Company uses derivatives classified as fair value hedges under SFAS 133. Once the hedge relationship is established, for those derivative instruments designated as qualifying fair value hedges, changes in the fair value of the derivative instruments and changes in the fair value of the hedged asset or liability attributable to the hedged risk are recorded in current earnings pursuant to SFAS 133. For the three and nine months ended September 30, 2005, the Company recognized a gain of $6.2 million and $11.0 million, respectively, which was substantially offset by changes in the fair value of the hedged assets. The gain (loss) has been included as a component of gain on sale of mortgage loans.

As of September 30, 2005, the Company had open Euro Dollar futures contracts that were designated as fair value hedges. The fair value of these contracts at September 30, 2005 was a $0.5 million liability and is included in accounts payable and accrued liabilities. The fair value of these contracts was substantially offset by changes in the fair value of the hedged assets.

Interest Rate Cap - Certain of the Company s securitizations structured as financings are subject to interest rate cap contracts, or caplets, designated and documented as cash flow hedges, used to mitigate interest rate risk. The change in the fair value of these interest rate cap contracts is recorded in other comprehensive income each period. Amounts are reclassified out of other comprehensive income as the hedged transactions impact earnings. For the three and nine months ended September 30, 2005, the Company recorded interest expense of $1.3 million and $6.3 million, respectively, related to the amortization of the caplets. The related net change to other comprehensive income due to the amortization and change in fair value of the caplets was $0.2 million. At September 30, 2004, such caplets were not designated as hedges. The fair value of these caplets was $1.1 million at September 30, 2005 and is included in prepaid expenses and other assets.

During the nine months ended September 30, 2004, certain of the Company s securitizations structured as financings were subject to interest rate cap contracts, not designated and documented as hedges, used to mitigate interest rate risk. The change in the fair value of these interest rate cap contracts is recorded through earnings each period, and is included as a component of interest expense. For the three and nine months ended September 30, 2004, the Company recognized a loss of $0.4 million and $0.7 million, respectively, related to the change in fair value of these cap contracts. The fair value of these cap contracts at September 30, 2004 was $0.2 million and is included in prepaid expenses and other assets. At September 30, 2005, all cap contracts were designated as hedges.

Non-designated Hedge Instruments - For derivative financial instruments not designated as hedge instruments, realized and unrealized changes in fair value are recognized in the period in which the changes occur. The change in the fair value of Euro Dollar futures contracts not designated and documented as hedges used to hedge the fair value of the Company s residual assets is recorded through earnings each period, and is included as a component of gain on sale. During the three and nine months ended September 30, 2005, the Company recognized a loss of $3.0 million and $2.6 million, respectively, related to the change in fair value of these contracts. For the three and nine months ended September 30, 2004, the Company recognized a loss of $0.6 million and a gain $0.4 million, respectively, related to the change in the fair value of these contracts. The fair value of these contracts at September 30, 2004 was a $0.3 million liability and is included in accounts payable and accrued liabilities.

Interest Rate Locks - The Company is exposed to interest rate risk from the time an interest rate lock commitment (IRLC) is made to a residential mortgage applicant to the time the related mortgage loan is sold. Such interest rate risk is primarily related to the Company s newly-acquired operations. During this period, the Company is exposed to losses if the mortgage interest rates rise, because the value of the IRLC or mortgage loan declines. IRLCs are derivative instruments under SFAS 133 and are recorded at fair value with the changes in fair value recognized in current period earnings as a component of gain on sale of loans. To manage this interest rate risk, the Company utilizes primarily forward sales commitments. The forward sales commitments are derivatives under SFAS 133 and are recorded at fair value with the changes in fair value recognized in current period earnings as a component of gain on sales of loans. The aggregate fair value of derivative loan commitments on

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the consolidated balance sheet was a net asset of $2.9 million at September 30, 2005, and is included in prepaids and other assets. The change in fair value that was recognized in the earnings during the third quarter was a gain of $2.8 million, and is included as a component of gain on sale of mortgage loans.

14. Income Taxes

Commencing in 2004, New Century has operated so as to qualify as a REIT for federal income tax purposes and filed a separate federal income tax return that does not include the operations of the Company s non-REIT, or TRS, companies. Provided at least 90% of the taxable income of the REIT is distributed to stockholders in the manner prescribed by the Code, no income taxes are due on the income distributed in the form of dividends by the REIT. Effective tax rates for all periods reported upon in 2005 will therefore differ substantially from rates in 2004 when most of the operations of the Company were taxable. The table below outlines the calculation of tax expense and a comparison of the components comprising the differences in the tax rate for the consolidated group for the three and nine months ended 2005 and 2004 (dollars in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005			2004	2005			2004
	REIT	TRS	Total	Non-REIT	REIT	TRS	Total	Non-REIT
Earnings before income taxes	$ 104,413	18,558	122,971	182,112	248,234	59,292	307,526	500,965
Taxable REIT earnings in excess of GAAP Earnings	39,234	29,559	68,793	N/A	104,639	328	104,967	N/A
Taxable REIT and taxable TRS income	143,647	48,117	191,764	182,112	352,873	59,620	412,493	500,965
Expected dividend paid deduction for REIT level companies	(143,647)	N/A	(143,647)	N/A	(352,873)	N/A	(352,873)	N/A
Taxable income after REIT dividend paid deduction	$	48,117	48,117	182,112		59,620	59,620	500,965

Income tax expense by entity		(2,867)	(2,867)	(74,833)		(7,583)	(7,583)	(204,064)
Add back earnings before income taxes	104,413	18,558	122,971	182,112	248,234	59,292	307,526	500,965
Net earnings by entity	$ 104,413	15,691	120,104	107,279	248,234	51,709	299,943	296,901
Combined tax rate			2.33%	41.09%			2.47%	40.73%

For the nine months ended September 30, 2005, the Company s taxable REIT income exceeded its dividends paid to date on its common and preferred stock by approximately $80 million and net earnings by approximately $27 million.

The Code makes available procedures and tax elections to allow a REIT to carry over such excess earnings into the first quarter of the next tax year to more evenly match its taxable income to generally accepted accounting principles income and facilitate a more orderly and evenly distributed dividend program. Properly employed, these elections allow a REIT to avoid paying either excise or regular income tax on any taxable earnings thus carried forward into 2006.

Accordingly, in order to more closely match its taxable REIT income and the long-term performance characteristics of its portfolio loan assets with its dividend program, the Company intends to apply any excess taxable REIT income at year-end to the regular first quarter 2006 dividend payment. Therefore, the Company has accrued no tax on the additional earnings of $80 million at September 30, 2005.

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(Unaudited)

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The Company s third quarter 2005 results include a tax benefit adjustment of $14.8 million, or $0.26 per share, from finalizing amendments to its federal and state tax returns prompted by the completion of a recent Internal Revenue Service examination.

Additionally, during the third quarter of 2005, the Company executed mortgage subservicing agreements by and between its TRS and QRS. These agreements reduced the taxable income in the TRS by approximately $24.0 million for the three and nine months ended September 30, 2005. Such reduction resulted in tax savings of approximately $9.9 million in those periods.

15. 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic:				
Net earnings	$ 120,104	107,279	299,943	296,901
Less: Preferred stock dividends	2,567		2,852	
Net earnings available to common stockholders	$ 117,537	107,279	297,091	296,901
Weighted average number of common shares outstanding	55,870	33,405	55,346	33,241
Earnings per share	$ 2.10	3.21	5.37	8.93
Diluted:				
Net earnings available to common stockholders	$ 117,537	107,279	297,091	296,901

Add: Interest and amortization of debt issuance costs on convertible senior notes, net of tax	(30)	1,297	65	3,804
Diluted net earnings	$ 117,507	108,576	297,156	300,705
Weighted average number of common shares outstanding	55,870	33,405	55,346	33,241
Dilutive effect of convertible senior notes, stock options and restricted stock	1,728	9,504	2,075	9,121
	57,598	42,909	57,421	42,362
Earnings per share	$ 2.04	2.53	5.18	7.10

For the three and nine months ended September 30, 2005, the Company has included the effect of approximately 155,000 and 160,000 shares of common stock, respectively, issuable upon conversion of its convertible senior notes in the computation of diluted earnings per share. For the three and nine months ended September 30, 2004, the Company has included the effect of approximately 6.0 million shares of common stock issuable upon conversion of its convertible senior notes in the computation of diluted earnings per share. Diluted earnings have been adjusted to add the interest expense and amortization of debt issuance costs recorded related to the convertible senior notes, net of the applicable income tax effect.

For the three months ended September 30, 2005 and 2004, options to purchase 1,100,000 and 437,000 shares, respectively, of the Company s common stock were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive. For the nine months ended September 30, 2005 and 2004, options to purchase 489,000 and 24,000 shares, respectively, of the Company s common stock were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive.

16. Consolidating Financial Information

On February 14, 2005, New Century and New Century TRS entered into a second supplemental indenture in connection with New Century s agreement to guarantee the payment of New Century TRS s obligations with respect to its convertible senior notes (see Note 9 Convertible Senior Notes Private Offering).

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Unaudited Condensed Consolidating Schedule Balance Sheet

September 30, 2005

(Dollars in thousands)

The following is consolidating information as to the financial condition, results of operations and cash flows of New Century:

	New Century Financial Corporation	New Century Residual IV Corporation	New Century Credit Corporation	New Century TRS Holdings, Inc.	Eliminations	Consolidated
Assets						
Cash and cash equivalents	$ 332,768		1,000	196,291		530,059
Restricted cash		583,146		188,195		771,341
Mortgage loans held for sale, net				8,570,862		8,570,862
Mortgage loans held for investment, net		15,797,551	30,845	2,611,568	(109,651)	18,330,313
Residual interests in securitizations				172,111		172,111
Mortgage servicing assets				54,310		54,310
Accrued interest receivable		85,039	(122)	27,234		112,151
Income taxes, net				111,335		111,335
Office property and equipment, net				80,085		80,085
Goodwill, net				93,211		93,211
Prepaid expenses and other assets	385	106,582	73,169	29,529	51,800	261,465
Due to (from) affiliates	241,883	(146,290)	(27,954)	(67,639)		
Investment in subsidiary	1,625,204				(1,625,204)	
Total assets	$ 2,200,240	16,426,028	76,938	12,067,092	(1,683,055)	29,087,243
Liabilities and Stockholders Equity						
Credit facilities on mortgage loans held for sale	$			8,218,122		8,218,122
Financing on mortgage loans held for investment, net		15,614,811	15,230	2,607,368	(10,590)	18,226,819
Accounts payable and accrued liabilities	96,279	37,486	3,878	350,449		488,092
Convertible senior notes, net				4,931		4,931
Notes payable				45,318		45,318
Total liabilities	&n					