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

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2005

OR

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

For the transition period from __________ to __________

Commission file number 001-32314

NEW CENTURY FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	**56-2451736**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

18400 VON KARMAN, SUITE 1000,	
IRVINE, CALIFORNIA	**92612**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (949) 440-7030

Not Applicable

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

Indicate by check ¨ whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO ¨

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

YES x NO ¨

As of April 30, 2005, the registrant had 55,747,503 shares of common stock outstanding.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

FORM 10-Q

QUARTER ENDED MARCH 31, 2005

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Certain information included in this Form 10-Q may include forward-looking statements under federal securities laws, and we intend that such forward-looking statements be subject to the safe-harbor created thereby. Such statements include, without limitation, (i) our expectation that we will fully deploy the capital we raised in connection with our REIT conversion by the end of the second quarter of 2005; (ii) our expectation that our portfolio of mortgage assets will provide a relatively stable source of revenues and will contribute more than half of our earnings in 2005; (iii) our belief that our REIT structure provides the most tax-efficient way to hold mortgage loans on our balance sheet; (iv) our expectation that we will continue to increase the percentage of our net income generated from our mortgage loan portfolio, producing more diverse revenues across a variety of interest rate environments; (v) our expectation that a significant source of our revenue prospectively will be interest income generated from our portfolio of mortgage loans held by our REIT and our qualified REIT subsidiaries; (vi) our expectation that we will continue to generate revenue through our taxable REIT subsidiaries from the sale of loans, servicing income and loan origination fees; (vii) our expectation that the primary components of our expenses will be: interest expense on our credit facilities, securitizations and other borrowings; general and administrative expenses; and payroll and related expenses arising from our origination and servicing businesses; (viii) our expectation that our portfolio of mortgage assets will grow to $18 billion by the end of June 2005; (ix) our expectation that a majority of our future income will come from the interest we earn on the mortgage assets we hold for investment; (x) our expectation that we will supplement our income with earnings from our taxable REIT subsidiaries, which will continue to originate, service and sell mortgage loans; (xi) our belief that the impact of our cost-cutting measures designed to reduce our loan acquisition costs will occur in the remainder of 2005; (xii) our belief that our current rate of business is sustainable; (xiii) our belief that if we are successful in maintaining our current mix of production, our exposure to interest rate cyclicality will be somewhat reduced; (xiv) our belief that our strict underwriting guidelines and the stronger credit characteristics of our interest-only loans mitigate their perceived higher risk; (xv) our belief that the recognition of income as interest payments on the underlying mortgage loans will result in higher income recognition in future periods than would a securitization structured as a sale; (xvi) our beliefs with respect to our critical accounting policies; (xvii) our estimates and assumptions with respect to the interest rate environment; (xviii) our estimates and assumptions with respect to the economic environment; (xix) our estimates and assumptions with respect to secondary market conditions; (xx) our estimates and assumptions with respect to the performance of the loans underlying our residual assets and mortgage loans held for investment; (xxi) our estimates for our loan loss allowance; (xxii) the estimates we use for determining the value of our residuals; (xxiii) our estimates with respect to our average cumulative losses as a percentage of the original principal balance of mortgage loans; (xxiv) our beliefs with respect to our legal proceedings; (xxv) our expectation that our retail-branch offices will be transitioned to the Home123 brand by the end of the second quarter of 2005; (xxvi) our expectation that we will securitize approximately 20% to 30% of our loan production in connection with our conversion to a REIT; (xxvii) our expectations regarding our target levels of liquidity and capital; (xxviii) our expectation that our liquidity, credit facilities and capital resources will be sufficient to fund our operations for the foreseeable future, while enabling us to maintain our qualification as a REIT under the requirements of the Code; and (xxix) our expectation that we will access the capital markets when appropriate to support our growth and business prospects.

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

We assume no obligation to update the forward-looking statements contained in this Form 10-Q.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollars in thousands, except share amounts)

	March 31, 2005	December 31, 2004
	(Unaudited)	
Assets		
Cash and cash equivalents	$ 880,130	842,854
Restricted cash	480,800	454,035
Mortgage loans held for sale, net	3,874,414	3,922,865
Mortgage loans held for investment, net	15,836,203	13,195,324
Residual interests in securitizations	143,928	148,021
Mortgage servicing assets	14,448	8,249
Accrued interest receivable	76,162	66,208
Income taxes, net	85,874	180,840
Office property and equipment	59,974	47,266
Prepaid expenses and other assets	275,475	186,282
Total assets	$ 21,727,408	19,051,944
Liabilities and Stockholders Equity		
Credit facilities on mortgage loans held for sale	$ 3,651,181	3,704,268
Financing on mortgage loans held for investment, net	15,692,270	13,105,973
Accounts payable and accrued liabilities	381,349	320,108
Convertible senior notes, net	5,407	5,392
Notes payable	33,438	37,638
Total liabilities	19,763,645	17,173,379
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value. Authorized 10,000,000 shares; No shares issued and outstanding at March 31, 2005 and December 31, 2004		
Common stock, $0.01 par value. Authorized 300,000,000 shares; issued and outstanding 55,611,997 and 54,702,623 shares at March 31, 2005 and December 31, 2004, respectively	556	547
Additional paid-in capital	1,133,743	1,108,660
Accumulated other comprehensive income (loss)	71,137	(4,700)
Retained earnings, restricted	780,552	781,627
	1,985,988	1,886,134
Treasury stock, 2,500 shares at March 31, 2005 and December 31, 2004, respectively, at cost	(70)	(70)
Deferred compensation costs	(22,155)	(7,499)
Total stockholders equity	1,963,763	1,878,565

Total liabilities and stockholders equity	$ 21,727,408	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 March 31, 2005	Three Months Ended March 31, 2004
Interest income	$ 331,071	153,128
Interest expense	(162,081)	(55,964)
Net interest income	168,990	97,164
Provision for losses on mortgage loans held for investment	(30,238)	(19,869)
Net interest income after provision for losses	138,752	77,295
Other operating income:		
Gain on sale of mortgage loans	139,752	201,976
Servicing income	6,722	5,896
Other income	3,873	
Total other operating income	150,347	207,872
Other operating expenses:		
Personnel	128,522	80,966
General and administrative	41,775	29,832
Advertising and promotion	19,832	13,565
Professional services	7,806	4,337
Total operating expenses	197,935	128,700
Earnings before income taxes	91,164	156,467
Income taxes	6,404	69,222
Net earnings	$ 84,760	87,245
Basic earnings per share	$ 1.55	2.64
Diluted earnings per share	$ 1.48	2.11
Basic weighted average shares outstanding	54,779,457	32,996,574
Diluted weighted average shares outstanding	57,266,628	42,015,954

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 March 31,	
	2005	**2004**
Net earnings	$ 84,760	87,245
Other comprehensive income (loss):		
Unrealized gain (loss) on derivative instruments designated as hedges, net of taxes of $2,337, and ($8,872) at March 31, 2005 and March 31, 2004, respectively	75,837	(12,252)
Comprehensive income	$ 160,597	74,993

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Dollars in thousands)

(Unaudited)

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Cash flows from operating activities:		
Net earnings	$ 84,760	87,245
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	23,771	5,813
Cash flows received from residual interests	6,787	14,795
Accretion of NIRs	(4,024)	(4,780)
Servicing gains	(8,120)	
Fair value adjustment of residual securities	1,330	(1,442)
Provision for losses on mortgage loans held for investment	30,238	19,869
Provision for repurchase losses	548	1,357
Mortgage loans originated or acquired for sale	(6,480,899)	(6,898,797)
Mortgage loan sales, net	6,516,864	7,349,675
Principal payments on mortgage loans held for sale	41,014	37,314
Decrease in credit facilities on mortgage loans held for sale	(53,087)	(513,757)
Net change in other assets and liabilities	124,057	20,097
Net cash provided by operating activities	283,239	117,389
Cash flows from investing activities:		
Mortgage loans originated or acquired for investment, net	(3,803,344)	(1,519,964)
Principal payments on mortgage loans held for investment	1,102,785	256,370
Purchases of office property and equipment	(17,086)	(5,715)
Net cash used in investing activities	(2,717,645)	(1,269,309)
Cash flows from financing activities:		
Proceeds from issuance of financing on mortgage loans held for investment, net	2,888,602	
Repayments of financing on mortgage loans held for investment	(1,075,163)	(211,379)
Increase in credit facilities on mortgage loans held for investment	771,366	1,519,964
Proceeds from (net repayments of) notes payable	(4,200)	15,408
Change in restricted cash	(26,765)	(91,440)
Payment of dividends on common stock	(82,569)	(5,356)
Net proceeds from issuance of stock	411	(461)
Net cash provided by financing activities	2,471,682	1,226,736

Net increase in cash and cash equivalents		37,276	74,816
Cash and cash equivalents, beginning of period		842,854	278,598
Cash and cash equivalents, end of period	$	880,130	353,414
Supplemental cash flow disclosure:			
Interest paid	$	167,305	58,141
Income taxes paid	$	71,644	17,430
Supplemental non-cash financing activity:			
Restricted stock issued	$	17,619	6,102
Accrued dividends	$	85,803	

See accompanying notes to unaudited condensed consolidated financial statements.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

March 31, 2005 and 2004

1. Basis of Presentation

New Century TRS Holdings, Inc. (formerly known as New Century Financial Corporation) (New Century TRS), a Delaware corporation, 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) (New Century Credit), a wholly-owned subsidiary of New Century, was acquired in March 2000 by New Century Mortgage. NC Residual IV Corporation (NCRIV), a wholly-owned subsidiary of New Century, 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.) (New Century), a Maryland corporation. 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. (Merger Sub), a Delaware corporation formed by New Century for purposes of effecting the Merger, 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 s 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.

The accompanying condensed consolidated financial statements include the consolidated financial statements of the Company s wholly-owned subsidiaries, New Century TRS, New Century Credit, and NCRIV. All material intercompany balances and transactions are eliminated in consolidation. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America.

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, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

March 31, 2005 and 2004

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

Recent Accounting Developments

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R, Share-based Payment, or SFAS 123R. SFAS 123R is a revision of FASB Statement No. 123, Accounting for Stock-based Compensation, and supercedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. SFAS 123R requires an entity to measure the cost of employee services in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exception). That cost will be recognized over the period during which the employee is required to provide service in exchange for the award, or the requisite service period, which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. Employee share purchase plans will not result in recognition of compensation expense if certain conditions are met.

The notes to financial statements will 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. In April 2005, the Securities and Exchange Commission deferred the effective date of SFAS 123R. The Company will be required to apply the provisions of SFAS 123R beginning in 2006. There are three methods from which an entity may select to apply the provisions of SFAS 123R during the transition period: modified prospective application, modified retrospective application all periods, and modified retrospective application interim periods. The Company has been providing pro forma disclosure as to the impact of SFAS 123 in footnote 1 of the Notes to Condensed Consolidated Financial Statements Stock-Based Compensation.

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 March 31, 2005, restricted cash totaled $480.8 million, and included $42.0 million in cash held in a margin account associated with the Company s interest rate risk management activities, $418.8 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. 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 expect 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.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

March 31, 2005 and 2004

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 to be incurred in the foreseeable future. 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 rate, may also occur 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 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 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 1.60% to 4.36% for adjustable-rate securities and 1.98% to 5.04% for fixed-rate securities. 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 3.88% at March 31, 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 2.34 to 2.68 years for the Company s adjustable-rate securities and 2.40 to 3.51 years for its fixed-rate securities.

During the quarter ended March 31, 2005, the Residuals provided $6.8 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 three months ended March 31, 2005, the Company increased its prepayment rate assumptions based upon actual performance and made minor adjustments to certain other assumptions, resulting in a $1.3 million downward fair value adjustment for the quarter.

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.

NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

March 31, 2005 and 2004

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 March 31, 2005, there were $881.8 million 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 accounted 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 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.

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, 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 its Taxable REIT Subsidiaries, (TRS), whose income is fully taxable at regular corporate rates.

SFAS No. 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 Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations, in accounting for employee stock options rather than the alternative fair value accounting allowed by Financial Accounting Standards Board (FASB) Statement No. 123, Accounting for Stock-Based Compensation (SFAS 123). APB 25 provides that compensation expense relative to the Company s employee stock options is recorded over the vesting period only if the current market price of the underlying stock exceeds the exercise price. Under SFAS 123, the fair value of stock options at the date of grant is recognized in earnings over the vesting period of the options. In December 2002, FASB issued 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 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.

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

March 31, 2005 and 2004

As of March 31, 2005 and 2004, there were stock options outstanding for the purchase of 5,021,173 and 5,246,607 shares, respectively, of the Company s common stock. The weighted average fair value of the stock options granted during the quarters ended March 31, 2005 and 2004 was $9.24 and $15.60, respectively. 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 March 31,	
	2005	**2004**
Basic net earnings:		
As reported	$ 84,760	87,245
Compensation expense, net of related tax effects	(1,525)	(1,164)
Pro forma	$ 83,235	86,081
Diluted net earnings:		
As reported	$ 84,778	88,477
Compensation expense, net of related tax effects	(1,525)	(1,164)
Pro forma	$ 83,253	87,313
Basic earnings per share:		
As reported	$ 1.55	2.64
Pro forma	1.52	2.61
Diluted earnings per share:		
As reported	$ 1.48	2.11
Pro forma	1.47	2.11
Basic weighted average shares outstanding:		
As reported	54,779	32,997
Pro forma	54,779	32,997
Diluted weighted average shares outstanding:		
As reported	57,267	42,016
Pro forma	56,646	41,416

2. Mortgage Loans Held for Sale

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

	March 31, 2005	December 31, 2004
First trust deeds	$ 3,544,706	3,686,830
Second trust deeds	303,888	197,362
Net deferred origination costs	25,820	38,673
	$ 3,874,414	3,922,865

At March 31, 2005, the Company had mortgage loans held for sale of approximately $29.6 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 $620,000 for the three months ended March 31, 2005.

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(Unaudited)

March 31, 2005 and 2004

3. Mortgage Loans Held for Investment

For the three months ended March 31, 2005, the Company securitized $3.0 billion in loans through transactions structured as financings, resulting in an increase in its mortgage loans held for investment. A summary of the components of mortgage loans held for investment at March 31, 2005 and December 31, 2004 is as follows (dollars in thousands):

	March 31, 2005	December 31, 2004
Mortgage loans held for investment:		
Unpaid principal balance of mortgage loans	$ 15,818,177	13,169,595
Allowance for loan losses	(117,495)	(90,227)
Net deferred origination costs	135,521	115,956
	$ 15,836,203	13,195,324

As of March 31, 2005, the balance of mortgage loans held for investment included $1.6 billion of mortgage loans held for investment that were not yet securitized.

At March 31, 2005, the Company had mortgage loans held for investment of approximately $211.1 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 $9.9 million for the quarter ended March 31, 2005.

The following table presents a summary of the activity for the allowance for losses on mortgage loans held for investment for the three months ended March 31, 2005 and 2004 (dollars in thousands):

Three Months Ended

	March 31,	
	2005	2004
Beginning balance	$ 90,227	26,251
Additions	30,238	19,869
Charge-offs	(2,970)	(524)
	$ 117,495	45,596

4. Residual Interests in Securitizations

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

	March 31, 2005	December 31, 2004
Over-collateralization account	$ 155,723	158,755
Net interest receivable (NIR)	(11,795)	(10,734)
	$ 143,928	148,021

The net interest receivable, or NIR, balance above represents the discounted value of cash flows expected to be received from net interest spread, while the over-collateralization account represents the current, un-discounted balance of over-collateralization as of the period end.

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(Unaudited)

March 31, 2005 and 2004

The following table summarizes the activity in the over-collateralization OC accounts for the three months ended March 31, 2005 and 2004 (dollars in thousands):

	Three Months Ended March 31,	
	2005	2004
Balance, beginning of period	$ 158,755	169,905
Additional deposits to OC accounts	914	193
Release of cash from OC accounts	(3,946)	(3,132)
Balance, end of period	$ 155,723	166,966

The following table summarizes activity in the NIR accounts for the three months ended March 31, 2005 and 2004 (dollars in thousands):

	Three Months Ended March 31,	
	2005	2004
Balance, beginning of period	$ (10,734)	9,593
Cash received from NIRs	(3,755)	(11,856)
Accretion of NIRs	4,024	4,780
Fair value adjustment	(1,330)	1,442
Balance, end of period	$ (11,795)	3,959

During the three months ended March 31, 2005 and 2004, the Company did not complete any securitizations structured as sales, resulting in no additions to its residual interests. Purchasers of securitization bonds 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 carrying value of the Company s mortgage loan servicing rights. The following table summarizes activity in the mortgage servicing assets for the three months ended March 31, 2005 and 2004 (dollars in thousands):

	Three Months Ended March 31,	
	2005	2004
Balance, beginning of period	$ 8,249	1,900
Additions	8,120	
Amortization	(1,921)	(252)
Balance, end of period	$ 14,448	1,648

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 $8.1 million for the three months ended March 31, 2005 represents the value of servicing rights retained by the Company in certain of its whole loan sales. As of March 31, 2005, the Company had also retained the right to service the $14.3 billion of loans underlying its portfolio of mortgage loans held for investment.

6. Goodwill

Goodwill is recorded in connection with the acquisition of new subsidiaries and is included in prepaid expenses and other assets. As of March 31, 2005 and December 31, 2004, the Company had goodwill of $12.7 million. No impairment existed at March 31, 2005.

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(Unaudited)

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7. Credit Facilities and Other Short-Term Borrowings

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

	March 31, 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) between New Century Funding A, a Delaware business trust which is a wholly-owned subsidiary of New Century Mortgage, and Bank of America, N.A., expiring in July 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	785,683	975,119
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.	564,440	43,917
An $800 million aggregation facility ($400 million of which is uncommitted) from Bear Stearns Mortgage Capital expiring in October 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	504,127	428,397
A $700 million master repurchase agreement among New Century Credit, New Century Mortgage, NC Capital, NC Residual II, and IXIS Real Estate Capital Inc. expiring in September 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	237,122	617,141
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, successor to Salomon Brothers, expiring in June 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.		

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(Unaudited)

March 31, 2005 and 2004

	March 31, 2005	December 31, 2004
A $650 million repurchase agreement among New Century Credit, NC Capital and Citigroup Global Markets Reality Corp., successor to Salomon Brothers, expiring in June 2005, secured by mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	307,771	260,025
A $75 million master loan and security agreement among New Century Mortgage, NC Capital, New Century and Citigroup Global Markets Realty Corp., successor to Salomon Brothers Realty Corp., expiring in December 2005, secured by delinquent loans and REO properties, bearing interest based on a margin over one-month LIBOR.	417	959
A $250 million repurchase agreement between New Century Mortgage and Citigroup Global Markets, which expires in December 2005, secured by small balance commercial mortgage loans held for sale, bearing interest based on a margin over one-month LIBOR.	120,493	54,398
A $500 million master loan and security agreement among New Century Credit, New Century Mortgage, NC Capital 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.	248,784	
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.	1,075,575	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.	1,354,811	1,141,167
Less: Credit facility amounts reclassified to financing on mortgage loans held for investment	(1,548,042)	(776,677)
	$ 3,651,181	3,704,268

The various credit facilities contain certain restrictive financial and other covenants that require the Company and/or certain of its subsidiaries to, among other things, restrict dividends, maintain certain levels of net worth, liquidity, available borrowing capacity, and debt-to-net worth ratios and to comply with regulatory and investor requirements. The Company was in compliance with these covenants at March 31, 2005.

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(Unaudited)

March 31, 2005 and 2004

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 March 31, 2005 and December 31, 2004, the financing on mortgage loans held for investment consisted of the following (dollars in thousands):

	March 31, 2005	December 31, 2004
Securitized bonds	$ 14,192,048	12,379,524
Short-term financing on retained bonds	16,697	23,616
2003-NC5 NIM bond	2,652	7,583
Debt issuance costs	(67,169)	(81,427)
Credit facility amounts reclassified from warehouse credit facilities	1,548,042	776,677
Total financing on mortgage loans held for investment	$ 15,692,270	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 to be between 2.0 and 4.1 years. The following table reflects the estimated maturity of the financing on mortgage loans held for investment as of March 31, 2005 (dollars in thousands):

Due in less than 1 year	$ 5,295,485
Due in 2 years	4,416,327
Due in 3 years	1,773,926
Thereafter	4,206,532
	$ 15,692,270

9. Convertible Senior Notes Private Offering

On July 8, 2003, New Century TRS closed a private offering of $175 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 million principal amount of the convertible senior notes. The convertible senior notes bear interest at a rate of 3.50% per year 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. 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 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.

As of March 31, 2005, the number of shares of the Company s common stock into which the remaining convertible senior notes were convertible into was 161,582, subject to certain adjustments under the terms of the convertible senior notes. For example, the terms of the convertible senior notes allow for the bondholder s 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 March 31, 2005, the maximum number of shares of the Company s common stock into which the remaining untendered convertible senior notes were convertible into was 194,301, subject to certain adjustments under the terms of the convertible senior notes. On April 29, 2005, concurrent with the payment of a cash dividend of $1.55 per share, the number of shares into which the remaining notes were convertible was adjusted to 165,157.

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(Unaudited)

March 31, 2005 and 2004

10. Interest Income

The following table presents the components of interest income for the three months ended March 31, 2005 and 2004 (dollars in thousands):

	Three Months Ended March 31,	
	2005	2004
Interest on mortgage loans held for investment	$ 247,660	79,337
Interest on mortgage loans held for sale	76,199	68,992
Residual interest income	4,024	4,780
Other interest income	3,188	19
	$ 331,071	153,128

11. Interest Expense

The following table presents the components of interest expense for the three months ended March 31, 2005 and 2004 (dollars in thousands):

	Three Months Ended March 31,	
	2005	2004
Interest on financing on mortgage loans held for investment	$ 117,720	32,984
Interest on credit facilities and other short-term borrowings	42,206	19,943

Interest on convertible notes	63	2,124
Other interest expense	2,092	913
	$ 162,081	55,964

12. 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.

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(Unaudited)

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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 hedges or hedges that no longer qualify as effective, the effective position previously recorded is amortized or accreted into earnings with the hedged item.

For derivative financial instruments designated as cash flow hedge instruments, the Company evaluates the effectiveness of these hedges against the interest payments related to its financing on mortgage loans held for investment 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 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. There was no ineffective portion of these hedges during the three months ended March 31, 2005. The ineffective portion of these hedges was approximately $300,000 for the first quarter of March 31, 2004.

As of March 31, 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 March 31, 2005 was a $101.3 million asset and is included in prepaid expenses and other assets. The fair value of these contracts at March 31, 2004 was a $25.0 million liability, and is included in accounts payable and accrued liabilities. For the three months ended March 31, 2005, the Company recognized a gain of $6.7 million 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, since the hedged transaction will continue to affect future earnings. The amortization of $3.0 million for the three months ended March 31, 2005 has been recorded as a increase of interest expense related to the Company s financing on mortgage loans held for investment. As of March 31, 2005, the related other comprehensive income balance was ($27.9) million.

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 months ended March 31, 2005, the Company recognized a gain of $8.6 million, which was substantially offset by changes in the fair value of the hedged assets. The gain was included as a component of gain on sale.

As of March 31, 2005, the Company had open Euro Dollar futures contracts that were designated as fair value hedges. The fair value of these contracts at March 31, 2005 was a $1.1 million asset and is included in prepaid expenses and other assets. The fair value of these contracts was substantially offset by changes in the fair value of the hedged assets.

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 months ended March 31, 2005, the Company recorded an interest expense of $2.3 million 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 $161,000. At March 31, 2004 such caplets were not designated as hedges. The fair value of these caplets was $6.1 million at March 31, 2005 and is included in prepaid expenses and other assets.

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(Unaudited)

March 31, 2005 and 2004

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 mitigate interest rate risk in the Company s residual assets and mortgage loans held for investment (not previously designated as hedges) is recorded through earnings each period, and is included as a component of gain on sale. For the three months ended March 31, 2005 and 2004, the Company recognized gain of $395,000 and a loss of $2.1 million, respectively, related to the change in the fair value of these contracts. These contracts were settled at March 31, 2005, and as such had no fair value as of that date. The fair value of these contracts at March 31, 2004 was a $3.4 million liability, and is included in accounts payable and accrued liabilities.

During the three months ended March 31, 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 months ended March 31, 2004, the Company recognized interest expense of $2.1 million related to the change in fair value of these cap contracts. The fair value of these cap contracts at March 31, 2004 was $1.4 million and is included in prepaid expenses and other assets. At March 31, 2005, all cap contracts were designated as hedges.

13. Income Taxes

Commencing in 2004, New Century has operated so as to qualify as a REIT for federal income tax purposes and will file 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. However, any income not so distributed representing amounts retained by the Company above the 90% distribution requirement, and all income of the TRS companies are fully taxable at applicable state and federal rates.

Effective tax rates for the first quarter of 2005 will therefore differ substantially from the first quarter rates in 2004 where the entire operations of the Company were taxable at the highest states rates and the maximum 35% federal rate. The table below outlines the calculation of tax expense, including $750,000 of tax expense for undistributed REIT earnings and a calculation of tax for TRS earnings, including a permanent tax difference of $2.2 million during this first quarter. Additionally, provided is a comparison of the components comprising the differences in the tax rate for the consolidated group between the 2005 and 2004 (dollars in thousands):

	Three months ended March 31,			
	2005			2004
	REIT	TRS	Total	Non-REIT
Earnings before income taxes	$ 79,619	11,545	91,164	156,467
Taxable REIT earnings in excess of GAAP earnings	8,612	N/A	8,612	N/A
Taxable REIT and taxable TRS income	88,231	11,545	99,776	156,467
Expected dividend paid deduction for REIT level companies	(86,408)	N/A	(86,408)	N/A
Taxable income after REIT dividend paid deduction	$ 1,823	11,545	13,368	156,467
Income tax computation by entity	(747)	(5,657)	(6,404)	(69,222)
Add back earnings before income taxes	79,619	11,545	91,164	156,467
Net earnings by entity	$ 78,872	5,888	84,760	87,245
Combined tax rate for consolidated New Century			7.02%	44.24%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

March 31, 2005 and 2004

14. 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 March 31,	
	2005	2004
Basic:		
Net earnings	$ 84,760	87,245
Weighted average number of common shares outstanding	54,779	32,997
Earnings per share	$ 1.55	$ 2.64
Diluted:		
Net earnings	$ 84,760	87,245
Add: Interest and amortization of debt issuance costs on convertible senior notes, net of tax	18	1,232
Diluted net earnings	$ 84,778	88,477
Weighted average number of common shares outstanding	54,779	32,997
Dilutive effect of convertible senior notes, stock options and restricted stock	2,488	9,019
	57,267	42,016
Earnings per share	$ 1.48	$ 2.11

For the three months ended March 31, 2005 and 2004, the Company has included the effect of approximately 162,000 and 6.0 million shares, respectively, of its common stock related its senior convertible 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 senior convertible notes, net of the applicable income tax effect.

For the three months ended March 31, 2005, options to purchase 77,500 shares of the Company s common stock were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive. For the three months ended March 31, 2004, options to purchase 30,000 shares of the Company s common stock were excluded from the calculation of diluted earnings per share because their effect was anti-dilutive.

15. Consolidating Financial Information

On February 14, 2005, New Century Financial Corporation and New Century TRS entered into a second supplemental indenture in connection with New Century Financial Corporation s agreement to guarantee the payment of New Century TRS obligations with respect to its 3.50% convertible senior notes due 2008 (see Note 9 Convertible Senior Notes).

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Condensed Consolidating Schedule Balance Sheet

March 31, 2005

(Dollars in thousands)

(Unaudited)

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	$ 608,931		1,000	270,199		880,130
Restricted cash		333,179		147,621		480,800
Mortage loans held for sale, net				3,874,414		3,874,414
Mortgage loans held for investment, net		10,830,254	1,584,061	3,461,529	(39,641)	15,836,203
Residual interests in securitizations				143,928		143,928
Mortgage servicing assets				14,448		14,448
Accrued interest receivable		56,130	3,247	16,785		76,162
Income taxes, net				85,874		85,874
Office property and equipment				59,974		59,974
Prepaid expenses and other assets	479	113,960	2,505	138,307	20,224	275,475
Due to (from) affiliates	27,787	82,532	(15,932)	(94,387)		
Investment in subsidiary	1,412,451				(1,412,451)	
Total assets	$ 2,049,648	11,416,055	1,574,881	8,118,692	(1,431,868)	21,727,408
Liabilities and Stockholders Equity						
Credit facilities on mortgage loans held for sale	$			3,651,181		3,651,181
Financing on mortgage loans held for investment, net		10,699,607	1,548,042	3,444,621		15,692,270
Accounts payable and accrued liabilities	85,885	85,637		209,827		381,349
Convertible senior notes, net				5,407		5,407
Notes payable				33,438		33,438
Total liabilities	85,885	10,785,244	1,548,042	7,344,474		19,763,645
Commitments and contingencies						
Stockholders equity:						
Common stock	556					556
Additional paid-in capital	1,111,518	450,152	3,001		(453,153)	1,111,518

Accumulated other comprehensive income (loss)	71,137	93,710		(22,573)	(71,137)	71,137
Retained earnings, restricted	780,552	86,949	23,838	796,791	(907,578)	780,552
Total stockholders equity	1,963,763	630,811	26,839	774,218	(1,431,868)	1,963,763
Total liabilities and stockholders equity	$ 2,049,648	11,416,055	1,574,881	8,118,692	(1,431,868)	21,727,408

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidating Schedule Balance Sheet

December 31, 2004

(Dollars in thousands)

	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	$ 742,239		1,000	99,615		842,854
Restricted cash	9,000	274,408		170,627		454,035
Mortgage loans held for sale, net				3,922,865		3,922,865
Mortgage loans held for investment, net		8,582,010	806,479	3,834,614	(27,779)	13,195,324
Residual interests in securitizations				148,021		148,021
Mortgage servicing assets				8,249		8,249
Accrued interest receivable		43,374	1,328	21,506		66,208
Income taxes, net				180,840		180,840
Office property and equipment				47,266		47,266
Prepaid expenses and other assets	213	40,062	1,694	126,066	18,247	186,282
Due to (from) affiliates	(30,568)	44,288	39,006	(52,726)		
Investment in subsidiary	1,240,315				(1,240,315)	
Total assets	$ 1,961,199	8,984,142	849,507	8,506,943	(1,249,847)	19,051,944
Liabilities and Stockholders Equity						
Credit facilities on mortgage loans held for sale	$			3,704,268		3,704,268
Financing on mortgage loans held for investment, net		8,467,650	776,676	3,861,647		13,105,973
Accounts payable and accrued liabilities	82,634	8,277	59,853	169,344		320,108
Convertible senior notes, net				5,392		5,392
Notes payable				37,638		37,638
Total liabilities	82,634	8,475,927	836,529	7,778,289		17,173,379
Commitments and contingencies						
Stockholders equity:						
Common stock	547					547
Additional paid-in capital	1,101,091	450,152	3,000		(453,152)	1,101,091
Accumulated other comprehensive income (loss)	(4,700)	23,608		(28,307)	4,699	(4,700)
Retained earnings, restricted	781,627	34,455	9,978	756,961	(801,394)	781,627
Total stockholders equity	1,878,565	508,215	12,978	728,654	(1,249,847)	1,878,565
Total liabilities and stockholders equity	$ 1,961,199	8,984,142	849,507	8,506,943	(1,249,847)	19,051,944

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidating Schedule Statements of Income

March 31, 2005 and 2004

(Dollars in thousands)

(Unaudited)

	March 31, 2005						March 31, 2004
	New Century Financial Corporation	New Century Residual IV Corporation	New Century Credit Corporation	New Century TRS Holdings, Inc.	Eliminations	Consolidated	New Century TRS Holdings, Inc.
Interest income	$ 2,328	167,994	19,575	144,399	(3,225)	331,071	153,128
Interest expense	(417)	(65,591)	(7,904)	(88,169)		(162,081)	(55,964)
Net interest income	1,911	102,403	11,671	56,230	(3,225)	168,990	97,164
Provision for losses on mortgage loans held for investment		(29,151)		(1,087)		(30,238)	(19,869)
Net interest income after provision for losses	1,911	73,252	11,671	55,143	(3,225)	138,752	77,295
Other operating income:							
Gain (loss) on sale of mortgage loans		513		154,891	(15,652)	139,752	201,976
Servicing fees received (paid)		(11,976)	(136)	18,834		6,722	5,896
Other income		444	2,325	1,104		3,873	
Equity in net earnings of subsidiary	87,816				(87,816)		
Total other operating income	87,816	(11,019)	2,189	174,829	(103,468)	150,347	207,872
Other operating expenses:							
Personnel	1,644			126,878		128,522	80,966
General and administrative	3,198			38,577		41,775	29,832
Advertising and promotion				19,832		19,832	13,565
Professional services	125			7,681		7,806	4,337
Total operating expenses	4,967			192,968		197,935	128,700
Earnings before income taxes	84,760	62,233	13,860	37,004	(106,693)	91,164	156,467
Income taxes		747		5,657		6,404	69,222

Net earnings	$ 84,760	61,486	13,860	31,347	(106,693)	84,760	87,245

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NEW CENTURY FINANCIAL CORPORATION AND SUBSIDIARIES

Condensed Consolidating Statements of Cash Flows

Periods ended March 31, 2005 and 2004

(Dollars in thousands)

(Unaudited)

	March 31, 2005						March 31, 2004
	New Century Financial Corporation	New Century Residual IV Corporation	New Century Credit Corporation	New Century TRS Holdings, Inc.	Eliminations	Consolidated	New Century TRS Holdings, Inc.
Cash flows from operating activities:							
Net earnings	$ 84,760	61,486	13,860	31,347	(106,693)	84,760	87,245
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:							
Depreciation and amortization	1,644	16,526		5,601		23,771	5,813
Cash flows received from residual interests				6,787		6,787	14,795
Accretion of NIRs				(4,024)		(4,024)	(4,780)
Servicing gains				(8,120)		(8,120)	
Fair value adjustment of residual securities				1,330		1,330	(1,442)
Provision for losses on mortgage loans held for investment		29,151		1,087		30,238	19,869
Provision for repurchase losses				548		548	1,357
Mortgage loans originated or acquired for sale				(6,480,899)		(6,480,899)	(6,898,797)
Mortgage loan sales, net				6,516,864		6,516,864	7,349,675
Principal payments on mortgage loans held for sale				41,014		41,014	37,314
Increase in credit facilities on mortgage loans held for sale				(53,087)		(53,087)	(513,757)
Due to (from) affiliates	(58,355)	(38,244)	54,938	41,661			
Net change in other assets and liabilities	(383)	57,659	(62,582)	122,348	7,015	124,057	20,097
Equity in undistributed earnings of subsidiaries	(87,816)				87,816		