

DOWNEY FINANCIAL CORP

Form 10-Q

May 04, 2007

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

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **March 31, 2007**

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 **1-13578**

**DOWNEY FINANCIAL CORP.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**33-0633413**

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

**3501 Jamboree Road, Newport Beach, CA**

(Address of principal executive office)

**92660**

(Zip Code)

Registrant's telephone number, including area code

**(949) 854-0300**

**N/A**

(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

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was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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

At March 31, 2007, 27,853,783 shares of the Registrant's Common Stock, \$0.01 par value were outstanding.

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Page

[Navigation Links](#)

**DOWNEY FINANCIAL CORP.**

**March 31, 2007 QUARTERLY REPORT ON FORM 10-Q**

**TABLE OF CONTENTS**

*PART I FINANCIAL INFORMATION*

ITEM 1.	FINANCIAL STATEMENTS	1
	Consolidated Balance Sheets at March 31, 2007 and 2006 and December 31, 2006	1
	Consolidated Statements of Income for the three months ended March 31, 2007 and 2006	2
	Consolidated Statements of Comprehensive Income for the three months ended March 31, 2007 and 2006	3
	Consolidated Statements of Cash Flows for the three months ended March 31, 2007 and 2006	4
	Notes To Consolidated Financial Statements	6
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	17
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	49
ITEM 4.	CONTROLS AND PROCEDURES	49

*PART II OTHER INFORMATION*

ITEM 1.	LEGAL PROCEEDINGS	50
ITEM 1A.	RISK FACTORS	50
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	50
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	50
ITEM 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	50
ITEM 5.	OTHER INFORMATION	50
ITEM 6.	EXHIBITS	51
	AVAILABILITY OF REPORTS	51
	SIGNATURES	51



**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****DOWNEY FINANCIAL CORP. AND SUBSIDIARIES****Consolidated Balance Sheets**

(Dollars in Thousands, Except Per Share Data)

	March 31, 2007	December 31, 2006	March 31, 2006
<b>Assets</b>			
Cash	\$ 157,084	\$ 124,865	\$ 168,822
Federal funds	-	1	-
Cash and cash equivalents	157,084	124,866	168,822
U.S. Treasury, government sponsored entities and other investment securities available for sale, at fair value	1,411,258	1,433,176	730,402
Loans held for sale, at lower of cost or fair value	267,862	363,215	561,511
Mortgage-backed securities available for sale, at fair value	117	251	271
Loans held for investment	13,002,795	13,868,227	15,912,318
Allowance for loan losses	(60,758 )	(60,943 )	(44,504 )
Loans held for investment, net	12,942,037	13,807,284	15,867,814
Investments in real estate and joint ventures	61,663	59,843	49,182
Real estate acquired in settlement of loans	17,212	8,524	385
Premises and equipment	115,534	114,052	110,595
Federal Home Loan Bank stock, at cost	126,125	152,953	182,557
Mortgage servicing rights, net	20,689	21,196	20,165
Other assets	118,288	122,022	111,055
	\$ 15,237,869	\$ 16,207,382	\$ 17,802,759
<b>Liabilities and Stockholders Equity</b>			
Deposits	\$ 11,647,431	\$ 11,784,869	\$ 12,198,903
Securities sold under agreements to repurchase	546,870	469,971	-
Federal Home Loan Bank advances	1,298,197	2,140,785	3,825,811
Senior notes	198,305	198,260	198,129
Accounts payable and accrued liabilities	93,977	220,262	317,976
Deferred income taxes	13,626	-	17,301
Total liabilities	13,798,406	14,814,147	16,558,120
<b>Stockholders equity</b>			

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Preferred stock, par value of \$0.01 per share; authorized 5,000,000 shares;

outstanding none	-	-	-
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Common stock, par value of \$0.01 per share; authorized 50,000,000 shares;

issued 28,235,022 shares at March 31, 2007, December 31, 2006 and			
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March 31, 2006; outstanding 27,853,783 shares at March 31, 2007,			
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December 31, 2006 and March 31, 2006	282	282	282
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Additional paid-in capital	93,792	93,792	93,792
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Accumulated other comprehensive loss	(1,676 )	(5,204 )	(6,196 )
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Retained earnings	1,363,857	1,321,157	1,173,553
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Treasury stock, at cost, 381,239 shares at March 31, 2007,			
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December 31, 2006 and March 31, 2006	(16,792 )	(16,792 )	(16,792 )
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Total stockholders equity	1,439,463	1,393,235	1,244,639
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	\$ 15,237,869	\$ 16,207,382	\$ 17,802,759
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*See accompanying notes to consolidated financial statements.*

**DOWNEY FINANCIAL CORP. AND SUBSIDIARIES****Consolidated Statements of Income**

*Three Months Ended  
March 31,*

*(Dollars in Thousands, Except Per Share Data)*

	2007	2006
<b>Interest income</b>		
Loans	\$ 252,172	\$ 255,345
U.S. Treasury and government sponsored entities securities	19,174	7,336
Mortgage-backed securities	3	3
Other investment securities	2,471	2,279
<b>Total interest income</b>	<b>273,820</b>	<b>264,963</b>
<b>Interest expense</b>		
Deposits	113,575	91,835
Federal Home Loan Bank advances and other borrowings	31,830	43,914
Senior notes	3,301	3,298
<b>Total interest expense</b>	<b>148,706</b>	<b>139,047</b>
<b>Net interest income</b>	<b>125,114</b>	<b>125,916</b>
<b>Provision for credit losses</b>	<b>617</b>	<b>10,057</b>
<b>Net interest income after provision for credit losses</b>	<b>124,497</b>	<b>115,859</b>
<b>Other income, net</b>		
Loan and deposit related fees	8,836	8,558
Real estate and joint ventures held for investment, net	476	2,289
Secondary marketing activities:		
Loan servicing income (loss), net	(436 )	189
Net gains on sales of loans and mortgage-backed securities	8,740	11,654
Other	72	520
<b>Total other income, net</b>	<b>17,688</b>	<b>23,210</b>
<b>Operating expense</b>		
Salaries and related costs	42,234	40,780
Premises and equipment costs	8,809	8,538
Advertising expense	1,191	1,242
Deposit insurance premiums and regulatory assessments	2,764	1,014

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Professional fees	559	792
Other general and administrative expense	9,795	9,175
<hr/>		
Total general and administrative expense	65,352	61,541
Net operation of real estate acquired in settlement of loans	291	(9 )
<hr/>		
Total operating expense	65,643	61,532
<hr/>		
<b>Income before income taxes</b>	76,542	77,537
Income taxes	33,679	33,840
<hr/>		
<b>Net income</b>	\$ 42,863	\$ 43,697
<hr/>		
<b>Per share information</b>		
Basic	\$ 1.54	\$ 1.57
Diluted	\$ 1.54	\$ 1.57
Cash dividends declared and paid	\$ 0.12	\$ 0.10
<b>Weighted average shares outstanding</b>		
Basic	27,853,783	27,853,783
Diluted	27,884,030	27,883,221
<hr/>		

*See accompanying notes to consolidated financial statements.*

**DOWNEY FINANCIAL CORP. AND SUBSIDIARIES****Consolidated Statements of Comprehensive Income**

*Three Months Ended  
March 31,*

<i>(In Thousands)</i>	<i>2007</i>	<i>2006</i>
<b>Net income</b>	\$ 42,863	\$ 43,697
<b>Other comprehensive income (loss), net of income taxes (benefits)</b>		
Unrealized gains (losses) on securities available for sale:		
U.S. Treasury, government sponsored entities and other investment		
securities available for sale, at fair value	3,587	(1,367 )
Mortgage-backed securities available for sale, at fair value	1	-
Reclassification of realized amounts included in net income	-	-
Unrealized gains (losses) on cash flow hedges:		
Net derivative instruments	154	503
Reclassification of realized amounts included in net income	(214 )	76
<b>Total other comprehensive income (loss), net of income taxes (benefits)</b>	<b>3,528</b>	<b>(788 )</b>
<b>Comprehensive income</b>	<b>\$ 46,391</b>	<b>\$ 42,909</b>

*See accompanying notes to consolidated financial statements.*

**DOWNEY FINANCIAL CORP. AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

*Three Months Ended*  
*March 31,*

*(In Thousands)*

2007                      2006

**Cash flows from operating activities**

Net income	\$ 42,863	\$ 43,697
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation	3,475	3,285
Amortization	30,523	26,076
Provision for losses on loans, loan-related commitments, investments in		
real estate and joint ventures, mortgage servicing rights,		
real estate acquired in settlement of loans, and other assets	692	10,018
Net gains on sales of loans and mortgage-backed securities, mortgage servicing rights,		
investment securities, real estate and other assets	(8,921 )	(12,618 )
Interest capitalized on loans (negative amortization)	(77,796 )	(64,827 )
Federal Home Loan Bank stock dividends	(2,413 )	(2,274 )
Loans originated and purchased for sale	(640,669 )	(980,164 )
Proceeds from sales of loans held for sale, including those sold		
as mortgage-backed securities	721,268	887,037
Other, net	(113,184 )	(17,817 )
<b>Net cash used by operating activities</b>	<b>(44,162 )</b>	<b>(107,587 )</b>

**Cash flows from investing activities**

Proceeds from:

Sales of Federal Home Loan Bank stock	29,241	-
Maturities or calls of U.S. Treasury, government sponsored entities		
and other investment securities available for sale	128,150	4,750
Sales of wholly owned real estate and real estate acquired in settlement of loans	2,871	681
Purchase of:		
U.S. Treasury, government sponsored entities and other investment securities		
available for sale	(100,000 )	(61,225 )
Loans held for investment	-	(12,218 )
Premises and equipment	(5,455 )	(9,902 )
Federal Home Loan Bank stock	-	(439 )

Originations of loans held for investment (net of refinances of \$229,941 for the

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three months ended March 31, 2007 and \$199,203 for the three months ended

March 31, 2006)	(390,457 )	(1,621,617 )
Principal payments on loans held for investment and mortgage-backed securities		
available for sale	1,330,381	1,194,760
Net change in undisbursed loan funds	(12,537 )	(2,881 )
Other, net	610	6,496
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Net cash provided by (used for) investing activities	982,804	(501,595 )
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*See accompanying notes to consolidated financial statements.*

**DOWNEY FINANCIAL CORP. AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows (Continued)**

*Three Months Ended  
March 31,*

*(In Thousands)*

2007

2006

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**Cash flows from financing activities**

Net increase (decrease) in depo