

DOWNEY FINANCIAL CORP

Form 10-Q

November 01, 2005

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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 **September 30, 2005**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number **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

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At September 30, 2005, 27,853,783 shares of the Registrant's Common Stock, \$0.01 par value were outstanding.

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## DOWNEY FINANCIAL CORP.

### September 30, 2005 QUARTERLY REPORT ON FORM 10-Q

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

(Dollars in Thousands, Except Per Share Data)

*September 30,*      *December 31,*      *September 30,*  
2005                      2004                      2004

**Assets**

Cash	\$ 171,225	\$ 119,502	\$ 107,038
Federal funds	2	-	-

Cash and cash equivalents	171,227	119,502	107,038
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U.S. Treasury, agency and other investment securities available for sale,

at fair value	550,621	497,009	732,878
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Loans held for sale, at lower of cost or fair value	495,035	1,118,475	845,913
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Mortgage-backed securities available for sale, at fair value	284	304	315
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Loans held for investment	14,883,882	13,458,713	13,445,697
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Allowance for loan losses	(35,998 )	(34,714 )	(34,551 )
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Loans held for investment, net	14,847,884	13,423,999	13,411,146
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Investments in real estate and joint ventures	49,351	55,411	44,242
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Real estate acquired in settlement of loans	2,323	2,555	2,819
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Premises and equipment	105,996	106,238	107,429
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Federal Home Loan Bank stock, at cost	222,228	243,613	209,063
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Mortgage servicing rights, net	19,117	17,964	82,295
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Other assets	101,795	63,738	96,326
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	\$ 16,565,861	\$ 15,648,808	\$ 15,639,464
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**Liabilities and Stockholders Equity**

Deposits	\$ 11,752,236	\$ 9,657,978	\$ 9,551,333
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Securities sold under agreements to repurchase	-	-	251,875
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Federal Home Loan Bank advances	3,162,808	4,559,622	4,418,729
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Senior notes	198,045	197,924	197,886
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Accounts payable and accrued liabilities	150,361	108,217	115,971
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Deferred income taxes	130,883	117,416	138,045
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Total liabilities	15,394,333	14,641,157	14,673,839
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**Stockholders equity**

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

outstanding none - - -

Common stock, par value of \$0.01 per share; authorized  
50,000,000 shares;

issued 28,235,022 shares at September 30, 2005,  
December 31, 2004 and

September 30, 2004; outstanding 27,853,783  
shares at September 30, 2005,

December 31, 2004 and September 30, 2004 282 282 282

Additional paid-in capital 93,792 93,792 93,792

Accumulated other comprehensive income (loss) (2,995 ) 318 1,926

Retained earnings 1,097,241 930,051 886,417

Treasury stock, at cost, 381,239 shares at September 30,  
2005,

December 31, 2004 and September 30, 2004 (16,792 ) (16,792 ) (16,792 )

Total stockholders equity 1,171,528 1,007,651 965,625

\$ 16,565,861 \$ 15,648,808 \$ 15,639,464

*See accompanying notes to consolidated financial statements.*

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

	<i>Three Months Ended September 30,</i>		<i>Nine Months Ended September 30,</i>	
<i>(Dollars in Thousands, Except Per Share Data)</i>	2005	2004	2005	2004
<b>Interest income</b>				
Loans	\$ 191,357	\$ 141,458	\$ 554,005	\$ 380,301
U.S. Treasury and agency securities	5,331	5,765	15,198	16,161
Mortgage-backed securities	3	3	9	9
Other investment securities	2,374	1,975	8,032	4,767
<b>Total interest income</b>	<b>199,065</b>	<b>149,201</b>	<b>577,244</b>	<b>401,238</b>
<b>Interest expense</b>				
Deposits	74,900	40,715	184,885	107,977
Federal Home Loan Bank advances and other borrowings	33,554	22,490	107,106	54,738
Senior notes	3,296	3,294	9,887	3,586
Junior subordinated debentures	-	765	-	7,033
<b>Total interest expense</b>	<b>111,750</b>	<b>67,264</b>	<b>301,878</b>	<b>173,334</b>
<b>Net interest income</b>	<b>87,315</b>	<b>81,937</b>	<b>275,366</b>	<b>227,904</b>
<b>Provision for (reduction of) loan losses</b>	<b>(751 )</b>	<b>1,186</b>	<b>1,870</b>	<b>4,448</b>
<b>Net interest income after provision for (reduction of) loan losses</b>	<b>88,066</b>	<b>80,751</b>	<b>273,496</b>	<b>223,456</b>
<b>Other income, net</b>				
Loan and deposit related fees	32,284	15,828	77,436	42,703
Real estate and joint ventures held for investment, net	3,307	365	7,615	8,339
Secondary marketing activities:				
Loan servicing income (loss), net	2,166	(16,890 )	1,121	(17,349 )
Net gains on sales of loans and mortgage-backed securities	29,499	14,637	108,962	31,684
Net gains on sales of mortgage servicing rights	19	-	1,000	-
Net gains (losses) on sales of investment securities	-	-	28	(19,159 )
Litigation award	-	-	1,767	-
Loss on extinguishment of debt	-	(4,111 )	-	(4,111 )
Other	971	393	1,830	1,248
<b>Total other income, net</b>	<b>68,246</b>	<b>10,222</b>	<b>199,759</b>	<b>43,355</b>
<b>Operating expense</b>				

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Salaries and related costs	38,155	36,629	116,352	109,773
Premises and equipment costs	8,079	8,771	23,970	25,179
Advertising expense	1,557	1,494	4,458	4,367
SAIF insurance premiums and regulatory assessments	957	825	2,811	2,326
Professional fees	(69 )	387	612	1,111
Other general and administrative expense	9,938	9,909	26,935	27,823
<hr/>				
Total general and administrative expense	58,617	58,015	175,138	170,579
Net operation of real estate acquired in settlement of loans	91	36	76	(273 )
<hr/>				
Total operating expense	58,708	58,051	175,214	170,306
<hr/>				
<b>Income before income taxes</b>	97,604	32,922	298,041	96,505
Income taxes	37,868	8,412	122,496	35,262
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<b>Net income</b>	\$ 59,736	\$ 24,510	\$ 175,545	\$ 61,243
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<b>Per share information</b>				
Basic	\$ 2.14	\$ 0.88	\$ 6.30	\$ 2.19
Diluted	\$ 2.14	\$ 0.88	\$ 6.30	\$ 2.19
Cash dividends declared and paid	\$ 0.10	\$ 0.10	\$ 0.30	\$ 0.30
<b>Weighted average shares outstanding</b>				
Basic	27,853,783	27,918,124	27,853,783	27,941,520
Diluted	27,884,352	27,943,512	27,883,489	27,970,788

*See accompanying notes to consolidated financial statements.*

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

	<i>Three Months Ended</i>		<i>Nine Months Ended</i>	
	<i>September 30,</i>		<i>September 30,</i>	
<i>(In Thousands)</i>	<i>2005</i>	<i>2004</i>	<i>2005</i>	<i>2004</i>
<b>Net income</b>	\$ 59,736	\$ 24,510	\$ 175,545	\$ 61,243
<b>Other comprehensive income (loss), net of income taxes (benefits)</b>				
Unrealized gains (losses) on securities available for sale:				
U.S. Treasury, agency and other investment securities				
available for sale, at fair value	(1,962 )	6,849	(3,677 )	562
Mortgage-backed securities available for sale, at fair value	(1 )	-	-	(1 )
Reclassification of realized amounts included in net income	-	-	(17 )	173
Unrealized gains (losses) on cash flow hedges:				
Net derivative instruments	344	144	289	2,651
Reclassification of realized amounts included in net income	51	678	92	(2,266 )
<b>Total other comprehensive income (loss), net of income taxes (benefits)</b>	(1,568 )	7,671	(3,313 )	1,119
<b>Comprehensive income</b>	\$ 58,168	\$ 32,181	\$ 172,232	\$ 62,362

*See accompanying notes to consolidated financial statements.*



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

*Nine Months Ended*  
*September 30,*

*(In Thousands)*

2005

2004

**Cash flows from operating activities**

Net income	\$ 175,545	\$ 61,243
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	77,618	68,522
Provision for losses on loans, real estate acquired in settlement of loans, investments		
in real estate and joint ventures, mortgage servicing rights and other assets	107	19,811
Net gains on sales of loans and mortgage-backed securities, mortgage servicing rights,		
investment securities, real estate and other assets	(114,223 )	(19,194 )
Interest capitalized on loans (negative amortization)	(85,789 )	(11,555 )
Federal Home Loan Bank stock dividends	(7,618 )	(4,027 )
Loans originated and purchased for sale	(6,647,339 )	(4,261,617 )
Proceeds from sales of loans held for sale, including those sold		
as mortgage-backed securities	7,336,595	3,697,463
Other, net	(70,583 )	(102,974 )
<b>Net cash provided by (used for) operating activities</b>	<b>664,313</b>	<b>(552,328 )</b>

**Cash flows from investing activities**

Proceeds from sales of:		
U.S. Treasury, agency and other investment securities available for sale	-	1,259,216
Wholly owned real estate and real estate acquired in settlement of loans	12,934	19,406
Federal Home Loan Bank stock	46,364	-
Redemption of common securities in Downey Financial Capital Trust I	-	3,711
Proceeds from maturities of U.S. Treasury, agency and other investment securities		
available for sale	26,555	540,086
Purchase of:		
U.S. Treasury, agency and other investment securities available for sale	(86,601 )	(1,845,066 )
Loans held for investment	(39,196 )	(198,609 )
Federal Home Loan Bank stock		