

DOWNEY FINANCIAL CORP

Form 10-Q

May 01, 2008

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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, 2008**

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, 2008, 27,853,783 shares of the Registrant's Common Stock, \$0.01 par value were outstanding.

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**DOWNEY FINANCIAL CORP.**

**March 31, 2008 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 (unaudited)**

(Dollars in Thousands, Except Per Share Data)

	March 31, 2008	December 31, 2007	March 31, 2007
<b>Assets</b>			
Cash	\$ 88,776	\$ 83,840	\$ 157,084
Federal funds	-	5,900	-
Cash and cash equivalents	88,776	89,740	157,084
U.S. Treasury, government sponsored entities and other investment securities available for sale, at fair value	1,603,100	1,549,879	1,411,258
Loans held for sale, at lower of cost or fair value	109,253	103,384	267,862
Mortgage-backed securities available for sale, at fair value	109	111	117
Loans held for investment	11,163,254	11,381,327	13,002,795
Allowance for loan losses	(546,751 )	(348,167 )	(60,758 )
Loans held for investment, net	10,616,503	11,033,160	12,942,037
Investments in real estate and joint ventures	71,196	68,679	61,663
Real estate acquired in settlement of loans, net	189,127	115,623	17,212
Premises and equipment, net	113,602	115,846	115,534
Federal Home Loan Bank stock, at cost	71,397	70,964	126,125
Mortgage servicing rights:			
Measured at fair value	19,425	-	-
Lower of amortized cost or fair value	-	19,512	20,689
Other assets	165,487	120,073	118,288
Deferred tax asset, net	83,374	122,086	-
	\$ 13,131,349	\$ 13,409,057	\$ 15,237,869
<b>Liabilities and Stockholders Equity</b>			
Deposits	\$ 10,244,289	\$ 10,496,041	\$ 11,647,431
Securities sold under agreements to repurchase	103,000	-	546,870
Federal Home Loan Bank advances	1,434,602	1,197,100	1,298,197
Senior notes	198,494	198,445	198,305
Accounts payable and accrued liabilities	60,480	183,054	93,977
Deferred income taxes	-	-	13,626
Total liabilities	12,040,865	12,074,640	13,798,406

**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 March 31, 2008, December 31, 2007 and March 31, 2007; outstanding 27,853,783 shares at March 31, 2008, December 31, 2007 and March 31, 2007	282	282	282
Additional paid-in capital	93,792	93,792	93,792
Accumulated other comprehensive income (loss)	8,982	2,768	(1,676 )
Retained earnings	1,004,220	1,254,367	1,363,857
Treasury stock, at cost, 381,239 shares at March 31, 2008, December 31, 2007 and March 31, 2007	(16,792 )	(16,792 )	(16,792 )

Total stockholders equity	1,090,484	1,334,417	1,439,463
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	\$ 13,131,349	\$ 13,409,057	\$ 15,237,869
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*See accompanying notes to consolidated financial statements.*

**DOWNEY FINANCIAL CORP. AND SUBSIDIARIES****Consolidated Statements of Income (unaudited)**

*Three Months Ended  
March 31,*

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

	2008	2007
<b>Interest income</b>		
Loans	\$ 177,557	\$ 252,172
U.S. Treasury and government sponsored entities securities	20,488	19,174
Mortgage-backed securities	3	3
Other investment securities	1,078	2,471
<b>Total interest income</b>	<b>199,126</b>	<b>273,820</b>
<b>Interest expense</b>		
Deposits	96,428	113,575
Federal Home Loan Bank advances and other borrowings	15,669	31,830
Senior notes	3,304	3,301
<b>Total interest expense</b>	<b>115,401</b>	<b>148,706</b>
<b>Net interest income</b>	<b>83,725</b>	<b>125,114</b>
<b>Provision for credit losses</b>	<b>236,870</b>	<b>617</b>
<b>Net interest income (loss) after provision for credit losses</b>	<b>(153,145 )</b>	<b>124,497</b>
<b>Other income, net</b>		
Loan and deposit related fees	8,239	8,836
Real estate and joint ventures held for investment, net	(605 )	476
Secondary marketing activities:		
Loan servicing loss, net	(1,196 )	(436 )
Net gains on sales of loans and mortgage-backed securities	1,649	8,740
Net gains on sales of investment securities	837	-
Other	14	72
<b>Total other income, net</b>	<b>8,938</b>	<b>17,688</b>
<b>Operating expense</b>		
Salaries and related costs	39,702	42,234
Premises and equipment costs	8,997	8,809
Advertising expense	461	1,191

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Deposit insurance premiums and regulatory assessments	3,703	2,764
Professional fees	303	559
Impairment writedown of goodwill	3,149	-
Other general and administrative expense	8,480	9,795
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Total general and administrative expense	64,795	65,352
Net operation of real estate acquired in settlement of loans	24,196	291
<hr/>		
Total operating expense	88,991	65,643
<hr/>		
<b>Income (loss) before income taxes</b>	(233,198 )	76,542
Income taxes	14,499	33,679
<hr/>		
<b>Net income (loss)</b>	\$ (247,697 )	\$ 42,863
<hr/>		
<b>Per share information</b>		
Basic	\$ (8.89 )	\$ 1.54
Diluted	\$ (8.89 )	\$ 1.54
Cash dividends declared and paid	\$ 0.12	\$ 0.12
<b>Weighted average shares outstanding</b>		
Basic	27,853,783	27,853,783
Diluted	27,853,783	27,884,030
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See accompanying notes to consolidated financial statements.



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

*Three Months Ended  
March 31,*

*(In Thousands)*

2008

2007

<b>Net income (loss)</b>	\$ (247,697 )	\$ 42,863
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**Other comprehensive income (loss), net of income taxes**

Unrealized gains on securities available for sale:

U.S. Treasury, government sponsored entities and other investment

securities available for sale, at fair value	6,820	3,587
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Mortgage-backed securities available for sale, at fair value	-	1
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Reclassification of realized amounts included in net income	-	-
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Unrealized gains (losses) on cash flow hedges:

Net derivative instruments	(955 )	154
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Reclassification of realized amounts included in net income	349	(214 )
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<b>Total other comprehensive income, net of income taxes</b>	<b>6,214</b>	<b>3,528</b>
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<b>Comprehensive income (loss)</b>	<b>\$ (241,483 )</b>	<b>\$ 46,391</b>
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*See accompanying notes to consolidated financial statements.*

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

*Three Months Ended*  
*March 31,*

*(In Thousands)*

2008                      2007

**Cash flows from operating activities**

Net income (loss)	\$ (247,697 )	\$ 42,863
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Adjustments to reconcile net income to net cash used for operating activities:

Depreciation	3,588	3,475
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Amortization	7,231	30,523
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Impairment writedown of goodwill	3,149	
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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	254,725	692
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Net gains on sales of loans and mortgage-backed securities, mortgage servicing rights,

investment securities, real estate and other assets	(1,834 )	(8,921 )
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Interest capitalized on loans (negative amortization)	(34,869 )	(77,796 )
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Changes in fair value of mortgage servicing rights due to:		-
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Changes in valuation model inputs or assumptions	1,751	-
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Other changes	739	-
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Federal Home Loan Bank stock dividends	(965 )	(2,413 )
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Loans originated and purchased for sale	(237,356 )	(640,669 )
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Proceeds from sales of loans held for sale, including those sold

as mortgage-backed securities	229,481	721,268
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Other, net	(120,694 )	(113,184 )
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Net cash used for operating activities	(142,751 )	(44,162 )
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**Cash flows from investing activities**

Proceeds from:

Sales of wholly owned real estate and real estate acquired in settlement of loans	19,056	2,871
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Sales of Federal Home Loan Bank stock	2,400	29,241
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Maturities or calls of U.S. Treasury, government sponsored entities and other investment securities available for sale	215,950	128,150
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Purchase of:

U.S. Treasury, government sponsored entities and other investment securities

available for sale	(262,500 )	(100,000 )
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Premises and equipment	(2,230 )	(5,455 )
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Federal Home Loan Bank stock	(1,868 )	-
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Originations of loans held for investment (net of refinances of \$74,889 for the

three months ended March 31, 2008 and \$229,941 for the three months ended