AmNet Mortgage, Inc.
Form 10-Q
November 15, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
	For the quarterly period ended: September 30, 2004
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
	Commission File Number: 1-13485

AMNET MORTGAGE, INC.

(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	**33-0741174** (I.R.S. Employer Identification No.)
10421 Wateridge Circle, Suite 250 **San Diego, California** (Address of principal executive offices)	**92121** (Zip Code)

(858) 909-1200
(Registrant s telephone number, including area code)

(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.

ý YES o NO

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

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

Common Stock ($0.01)	7,310,194 as of October 29, 2004

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

AmNet Mortgage, Inc. and Subsidiaries

Consolidated Balance Sheets, unaudited

(in thousands, except share and per share data)

	September 30, 2004	December 31, 2003
ASSETS		
Cash and cash equivalents	$ 46,133	$ 44,400
Cash and cash equivalents restricted	2,100	2,100
Mortgage loans held for sale, net, pledged (lower of cost or market)	394,368	276,781
Bond collateral, mortgage loans, net	16,526	157,872
Bond collateral, real estate owned, net	671	3,380
Accounts receivable mortgage loans sold/funded	8,855	3,856
Income tax refunds receivable	3,488	
Derivative financial instruments	237	(1,224)
Accrued interest receivable	898	2,593
Deferred taxes	4,992	5,694
Other assets	6,183	5,520
	$ 484,451	$ 500,972
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Short-term debt	$ 380,791	$ 268,619
Accrued interest payable	677	494
Accrued expenses and other liabilities	9,904	12,950
Long-term debt, net	15,869	130,295
Total liabilities	407,241	412,358
Commitments and contingencies (Note 12)		
Minority interest	161	129
Stockholders Equity:		
Preferred stock, par value $.01 per share; 100,000 shares authorized; no shares issued and outstanding		
Common stock, par value $.01 per share; 24,900,000 shares authorized; 7,310,194 shares issued and outstanding in 2004, and 7,873,714 shares issued and outstanding in 2003	73	79
Additional paid-in-capital	103,739	108,719
Accumulated deficit	(26,763)	(20,313)
Total stockholders equity	77,049	88,485
	$ 484,451	$ 500,972

See accompanying notes to consolidated financial statements.

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AmNet Mortgage, Inc. and Subsidiaries

Consolidated Statements of Operations and Comprehensive Income (Loss), unaudited

(in thousands, except per share data)

	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004	For The Nine Months Ended September 30, 2003
Revenues				
Gain on sales of loans	$ 24,198	$ 9,580	$ 42,037	$ 62,760
Derivative financial instruments and market adjustments				
Derivative financial instruments forward sales of mortgage-backed securities and options to sell mortgage-backed securities	(7,793)	4,194	(2,423)	1,115
Market adjustment on interest rate lock commitments	(3,753)	10,955	(520)	2,539
Total derivative financial instruments and market adjustments	(11,546)	15,149	(2,943)	3,654
Interest on mortgage assets	8,227	13,046	24,437	32,684
Other income	281	558	1,010	1,021
Total revenue, net of derivative financial instruments and adjustments	21,160	38,333	64,541	100,119
Expenses				
Employee compensation and benefits	12,752	14,030	38,994	36,100
Interest expense	4,420	5,646	12,414	14,456
Office and occupancy expense	1,076	706	2,871	1,894
Provision for loan losses (bond collateral)	80	764	208	2,478
Gain on sale of real estate owned, net	(86)	(236)	(406)	(751)
Loss on bond collateral sold	(437)		4,872	
Professional fees	925	1,432	3,329	4,174
Other operating expenses	4,098	5,002	13,038	12,781
Total expenses	22,828	27,344	75,320	71,132
(Loss) income before income taxes	(1,668)	10,989	(10,779)	28,987
Income tax (benefit) provision	(683)	3,221	(4,328)	(442)
Net (loss) income	$ (985)	$ 7,768	$ (6,451)	$ 29,429
Basic weighted average shares outstanding	7,364,244	7,858,733	7,716,079	7,861,665
Diluted weighted average shares outstanding	7,364,244	8,521,286	7,716,079	8,524,218
Net (loss) income per share-basic	$ (0.13)	$ 0.99	$ (0.84)	$ 3.74
Net (loss) income per share-diluted	$ (0.13)	$ 0.91	$ (0.84)	$ 3.45

See accompanying notes to consolidated financial statements.

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AmNet Mortgage, Inc. and Subsidiaries

Consolidated Statements of Cash Flows, unaudited

(in thousands)

	For the Nine Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (6,451)	$ 29,429
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Loss on bond collateral sold	4,872	
Amortization of mortgage assets premiums	995	2,663
Amortization of CMO capitalized costs	474	265
Provision for loan losses	208	2,477
Change in real estate owned provision	473	1,573
Gain on sale of real estate owned, net	(406)	(751)
Proceeds from sale of mortgage loans held for sale	6,402,844	8,345,391
Mortgage loan originations	(6,520,430)	(8,322,279)
Increase in restricted cash		(975)
(Increase)/decrease in accounts receivable mortgage loans sold/funded	(4,999)	1,653
Increase in income tax refunds receivable	(3,488)	
Decrease in accrued interest receivable	1,695	1,543
Decrease/(increase) in deferred taxes	702	(9,865)
Increase in other assets	(661)	(2,322)
(Increase)/decrease in derivative financial instruments	(1,461)	1,519
Increase/(decrease) in accrued interest payable	183	(39)
(Decrease)/increase in accrued expenses and other liabilities	(3,045)	14,312
Increase in minority interest	32	26
Net cash (used in)/provided by operating activities	(128,463)	64,620
CASH FLOWS FROM INVESTING ACTIVITIES:		
Principal payments on bond collateral, mortgage loans	24,991	68,781
Proceeds from sale of bond collateral	111,150	
Proceeds from sale of real estate owned	1,771	7,627
Net cash provided by investing activities	137,912	76,408
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt	(29,410)	(84,437)
Payments on long-term debt from sale of bond collateral	(85,491)	
Increase/(decrease) in net borrowings from short-term debt	112,172	(25,776)
Stock options exercised	158	40
Purchase of treasury stock	(5,145)	(145)
Net cash used in financing activities	(7,716)	(110,318)
Net increase in cash and cash equivalents	1,733	30,710
Cash and cash equivalents at beginning of year	44,400	13,647
Cash and cash equivalents at end of period	$ 46,133	$ 44,357
Supplemental information:		
Interest paid	$ 12,232	$ 14,496
Taxes paid	$ 2,832	$ 160
Transfers from bond collateral, mortgage loans, net to real estate owned	$ 1,127	$ 4,378

See accompanying notes to consolidated financial statements.

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AMNET MORTGAGE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies and Practices

Basis of Financial Statement Presentation

In May 2004, American Residential Investment Trust, Inc. changed its name to AmNet Mortgage, Inc.

The consolidated financial statements include the accounts of AmNet Mortgage, Inc., a Maryland corporation, American Mortgage Network, Inc., a Delaware corporation and wholly-owned subsidiary of AmNet Mortgage, Inc., American Residential Eagle, Inc., a Delaware special purpose corporation and wholly-owned subsidiary of AmNet Mortgage Inc. and American Residential Eagle 2, Inc., a Delaware limited purpose corporation and wholly-owned subsidiary of American Residential Eagle, Inc. Substantially all of the assets of American Residential Eagle, Inc. are pledged to support long-term debt in the form of collateralized mortgage bonds and are not available for the satisfaction of general claims of AmNet Mortgage, Inc. American Residential Holdings, Inc. is an affiliate of AmNet Mortgage, Inc. that is consolidated in accordance with FASB Interpretation No. 46R Consolidation of Variable Interest Entities. All entities are together referred to as the Company or AmNet. The Company s exposure to loss on the assets pledged as collateral is limited to its net investment, as the collateralized mortgage bonds are non-recourse to the Company. All significant intercompany balances and transactions have been eliminated in the consolidation of AmNet. Certain reclassifications have been made to prior period amounts to conform to the current presentation.

In management s opinion, all adjustments necessary for a fair statement are reflected in the interim periods presented. These adjustments are of a normal recurring nature. The interim financial data as of September 30, 2004 and for the nine months ended September 30, 2004 and September 30, 2003 is unaudited; however, in the opinion of the Company, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods.

Sales of mortgage loans are accounted for under Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Mortgage loans are sold with the mortgage servicing rights released. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling prices and the carrying value of the related mortgage loans sold. Deferred origination fees and expenses are recognized at the time of sale.

In March 2004, the SEC released Staff Accounting Bulletin (SAB) No. 105, Application of Accounting Principles to Loan Commitments. The Company accounts for its commitments to extend credit as derivatives and records changes in fair value of the commitments in the statement of operations. The adoption of SAB No. 105 beginning in the second quarter of 2004 did not have a significant effect on the Company s financial statements.

In December 2003, the Accounting Standards Executive Committee issued Statement of Position 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer (SOP 03-3). SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. The SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor s initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. This SOP does not apply to loans originated by the Company. The Company is evaluating the applicability of this Statement to the Company s operations.

Please refer to the Company s Form 10-K for the year ending December 31, 2003, for a detailed discussion of all significant accounting policies.

Stock Options

The Company elected to apply APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for its stock-based compensation plans: the 2004 Equity Incentive Plan and 1997 Employee Stock Purchase Plan. Accordingly, no compensation cost has been recognized in the financial statements. SFAS No. 123 Accounting for Stock Based Compensation requires pro forma disclosures of expense computed as if the fair value-based method had been applied in the financial statements of companies that continue to account for such arrangements under Opinion No. 25.

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting For Stock Based Compensation Transition and Disclosure, which amends SFAS No. 123. SFAS No. 148 requires more prominent and frequent disclosures about the effects of stock-based compensation. The Company will continue to account for its stock based compensation according to the provisions of APB Opinion No. 25.

The FASB is currently considering amending SFAS No. 123, Accounting for Stock-Based Compensation, which will supercede APB Opinion No. 25, Accounting for Stock Issued to Employees. The proposed standard which is expected to be finalized in December, 2004 will require the Company to record compensation expense for all share-based compensation. If adopted, this proposed standard would have a negative impact on our earnings in future periods since stock options are issued periodically to qualified employees.

Had compensation cost for the Company s stock options been recognized based upon the estimated fair value on the grant date under the fair value methodology prescribed by SFAS No. 123, as amended by SFAS No. 148, the Company s net income (loss) and income per share would have been as follows (in thousands except income per share) (unaudited):

	Three Months Ended		**Nine Months Ended**	
	September 30, 2004	**September 30, 2003**	**September 30, 2004**	**September 30, 2003**
Net (loss) income as reported	$ (985)	$ 7,768	$ (6,451)	$ 29,429
Deduct: Total stock-based compensation expense determined under fair value-based method, net of tax effects (See Note 9)	(145)	(185)	(564)	(1,208)
Pro forma net (loss) income	$ (1,130)	$ 7,583	$ (7,015)	$ 28,221
(Loss) income per share:				
Basic as reported	$ (0.13)	$ 0.99	$ (0.84)	$ 3.74
Basic pro forma	$ (0.15)	$ 0.97	$ (0.91)	$ 3.59
Diluted as reported	$ (0.13)	$ 0.91	$ (0.84)	$ 3.45
Diluted pro forma	$ (0.15)	$ 0.89	$ (0.91)	$ 3.31

The assumptions used to calculate the fair value of options granted are evaluated and revised as necessary to reflect market conditions and the Company s experience. These assumptions have not changed from prior periods.

Note 2. Concentration of Mortgage Loan Sales

For the nine months ending September 30, 2004, the Company sold a majority of the mortgage loans it originated to two of its competitors, Countrywide Home Loans, Inc. (59%) and Wells Fargo Funding, Inc. (16%). The Company s considerations in deciding where to sell loans are price and operational efficiency. The Company also considers speed of execution and loan product guidelines. The Company believes that all of the loans it sells currently could be sold to a number of other investors.

Note 3. Income Per Share

The following table illustrates the computation of basic and diluted income per share (in thousands, except share and per share data) (unaudited):

	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003
Numerator:				
Numerator for basic (loss) income per share	$ (985)	$ 7,768	$ (6,451)	$ 29,429
Denominator:				
Denominator for basic (loss) income per share - weighted average number of common shares outstanding during the period	7,364,244	7,858,733	7,716,079	7,861,665
Denominator for diluted (loss) income per share	7,364,244	8,521,286	7,716,079	8,524,218
(Loss) income per share - basic	$ (0.13)	$ 0.99	$ (0.84)	$ 3.74
(Loss) income per share - diluted	$ (0.13)	$ 0.91	$ (0.84)	$ 3.45

For the nine months ended September 30, 2004 and 2003 there were 1,132,729 and 1,119,047 options, respectively, that were antidilutive and, therefore, not included in the calculations above.

Note 4. Mortgage Loans Held for Sale, net, pledged

AmNet has pledged loans held for sale totaling approximately $394.4 million to secure credit lines (warehouse facilities) from four financial institutions. (See Note 7. Short-Term Debt.). Mortgage loans held for sale at September 30, 2004 consist of loans which have been committed for sale of approximately $286.4 million and loans available for sale of approximately $108.0 million, all of which are carried at the lower of cost or market value.

Note 5. Bond Collateral, Mortgage Loans, net

AmNet has pledged collateral in order to secure the long-term debt issued in the form of CMOs. Bond Collateral Mortgage Loans consist primarily of subprime credit, 30-year mortgage loans secured by first liens on one-to-four family residential properties. As of September 30, 2004 and 2003, 0% and 17.65%, respectively, of the bond collateral mortgage loans were fixed rate loans. The balance of the bond collateral mortgage loans are adjustable-rate mortgages. All Bond Collateral Mortgage Loans are pledged to secure repayment of the related long-term debt obligation. All principal and interest (less servicing and related fees) on the bond collateral is remitted to a trustee and is available for payment of the long-term debt obligation. The obligations under the long-term debt are payable solely from the bond collateral and are otherwise non-recourse to AmNet.

In March of 2004, approximately $113.9 million in Bond Collateral Mortgage Loans and approximately $2.3 million in REO bond collateral were reclassified as held for sale. By September 30, 2004 all of these mortgage loans including real estate owned, had been sold. One remaining portfolio (CMO/FASIT 1998-1) was not sold. Bond collateral for this structure is shown as Bond collateral, mortgage loans, net and Bond collateral, real estate owned, net.

Shown below are the components of bond collateral mortgage loans held for investment at September 30, 2004; compared to the same components at December 31, 2003 (dollars in thousands) (unaudited):

	CMO/REMIC 2000-2 Securitization	CMO/REMIC 1999-A Securitization	CMO 1999-2 Securitization	CMO 1999-1 Securitization	CMO/FASIT 1998-1 Securitization	TOTAL Bond Collateral
At September 30, 2004						
Mortgage loans	$ 0	$ 0	$ 0	$ 0	$ 16,648	$ 16,648
Unamortized premium	0	0	0	0	42	42
Allowance for loan losses	0	0	0	0	(164)	(164)
	$ 0	$ 0	$ 0	$ 0	$ 16,526	$ 16,526
Weighted average net coupon	0%	0%	0%	0%	9.43%	9.43%
Unamortized premiums as a percent of mortgage loans	0%	0%	0%	0%	0.25%	0.25%
At December 31, 2003						
Mortgage loans	$ 7,068	$ 40,435	$ 58,922	$ 27,021	$ 22,668	$ 156,114
Unamortized premium	362	809	1,747	749	102	3,769
Allowance for loan losses	(141)	(486)	(517)	(311)	(556)	(2,011)
	$ 7,289	$ 40,758	$ 60,152	$ 27,459	$ 22,214	$ 157,872
Weighted average net coupon	9.15%	9.49%	9.00%	8.88%	9.40%	9.17%
Unamortized premiums as a percent of mortgage loans	5.12%	2.00%	2.96%	2.77%	0.45%	2.41%

Note 6. Derivative Financial Instruments

AmNet makes commitments to fund mortgages at set interest rates, which are referred to as rate lock commitments. Additionally, most of the Company s loans are not yet committed for sale at the time of funding. Collectively, rate lock commitments and funded loans not yet committed for sale are the Company s pipeline. The value of the rate lock commitments and uncommitted loans will vary depending on changes in market interest rates between the time that a rate lock commitment is made and the time that the loan funds and is committed for sale to an investor.

AmNet estimates the number of rate lock commitments in the pipeline that will not close in order to calculate its interest rate exposure on a daily basis. AmNet then purchases hedging instruments in order to try to protect profit margins on the pipeline. The hedging instruments typically used are forward sales of mortgage-backed securities (TBA) and options on forward sales of mortgage-backed securities. Historically, changes in the price of these instruments closely relate to changes in the value (price) of loans in the pipeline.

At September 30, 2004 and September 30, 2003 AmNet had the following commitments to originate loans and loans not yet committed for sale to investors, and offsetting hedge coverage; (dollars in thousands) (unaudited) (Note that interest rate exposure does not directly correlate to hedge coverage without applying an option adjusted spread and fallout factor [for rate locks]):

	September 30, 2004	September 30, 2003
Interest rate exposure:		
Commitments to originate loans at set interest rates (after applying fallout)	$ 547,094	$ 545,758
Funded loans not yet committed for sale to investors	107,993	208,267
Hedge coverage:		
Forward sales of To Be Announced mortgage-backed securities (TBA)(notional amount)	547,000	682,000
Options on forward sales of mortgage-backed securities (notional amount)	30,000	180,000

The fair value of forward sales of mortgage-backed securities and options on forward sales of mortgage-backed securities are based on quoted market prices for these instruments. The rate lock commitments are also considered a derivative instrument and are assigned fair values based on the change in the quoted market value of the underlying loans due to market movements, less an estimated factor for loans that will not close (fallout ratio). The fallout ratio is affected by the Company s recent fallout history, interest rate changes and loan characteristics.

The following is a summary of the carrying value of AmNet s derivative instruments as of September 30, 2004 and December 31, 2003 (dollars in thousands) (unaudited):

September 30, 2004	Range of Coupon Rate	Range of Notional Amount	Fair Value	Range of Expiration Dates
Forward sales of mortgage-backed securities (TBAs):				
Fifteen year Fannie Mae	4.5-5.5 MBS	$ 500-20,000	$ (525)	Oct 19-Dec 16, 2004
Thirty year Fannie Mae	5.0-6.0 MBS	1,000-15,000	228	Oct 14-Dec 13, 2004
Thirty year Ginnie Mae	5.0-5.5 MBS	500-5,000	(137)	Oct 21-Dec 20, 2004
Forward commitment by investor	4.875-5.0	15,000	327	Nov15-Nov 30, 2004
Options on TBAs:				
Thirty year Fannie Mae	5.5 Puts	15,000	3	Oct 19, 2004
Rate lock commitments			341	
Total derivative financial instruments			$ 237	

December 31, 2003	Coupon Rate	Range of Notional Amount	Fair Value	Range of Expiration Dates
TBA				
Fifteen year Fannie Mae	4.5-5.5 MBS	$ 3,000-25,000	$ (803)	Jan 20-Mar 18, 2004
Twenty year Fannie Mae	4.5 MBS	2,000	56	Feb 12, 2004
Thirty year Fannie Mae	5.0-6.0 MBS	4,500-20,000	(1,388)	Jan 14-Mar 15, 2004
Thirty year Ginnie Mae	5.0-6.0 MBS	1,000-8,000	(122)	Jan 22-Feb 19, 2004
Options on TBAs:				
Thirty year Fannie Mae	5.5 Puts	50,000	172	Mar 15, 2004
Rate lock commitments			861	
Total derivative financial instruments			$ (1,224)	

The following is a summary of the components within Total derivative financial instruments and market adjustments income (expense) (dollars in thousands) (unaudited):

	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003
Derivative financial instruments - (expense) income:				
TBA (loss)/gain - closed positions	$(13,317)	$11,281	$(4,906)	$1,711
Options gain - closed positions		8,458	4,287	8,457
Change in value of TBAs - open positions	6,381	(12,902)	2,150	(4,535)
Change in value of Options - open positions	(857)	(2,643)	(3,954)	(4,518)
Change in market adjustment on interest rate lock commitments	(3,753)	10,955	(520)	2,539
Total derivative financial instruments and market adjustments (expense) income:	$(11,546)	$15,149	$(2,943)	$3,654

Note 7. Short-Term Debt

As of September 30, 2004, mortgage loans held for sale totaling $394.4 million were pledged as collateral for warehouse facility borrowings of $380.8 million with four financial institutions. At September 30, 2004, the Company s maximum borrowing capacity combined from these four financial institutions was $1.4 billion. The table below shows the age of pledged mortgage loans as of September 30, 2004. (in thousands) (unaudited):

Aging Range	Number of Loans		Warehouse line usage	% of Total
Less than 30 days	1,955	$	334,598	87.9%
30 to 60 days	336		42,389	11.1%
61 days to 90 days	35		3,804	1.0%
Total	2,326	$	380,791	100.0%

Of the $380.8 million of warehouse line usage at September 30, 2004, $122.4 million was funded through uncommitted warehouse facilities.

Warehouse facilities mature on various dates within two years, generally bearing interest at one-month LIBOR plus spread. The weighted average borrowing rates were 3.08% and 2.69% for the three month period ending September 30, 2004 and September 30, 2003 respectively. The weighted-average borrowing rate was 2.74% for the nine months ending September 30, 2004 and 2.71% for the nine months ending September 30, 2003. The weighted-average facility fee was .23% for the nine months ending September 30, 2004 and .25% for the nine months ending September 30, 2003 on the aggregate committed amount of the warehouse facilities. The warehouse facilities are repaid as principal payments on mortgage loans are received, or as the mortgage loans are sold. The agreements governing these facilities contain a number of covenants, including covenants based on tangible net worth, net income, and liquidity of the Company. As a result of the Company s third quarter net loss, the Company was out of compliance with certain of its warehouse lending agreements at September 30, 2004. The Company was out of compliance with earnings covenants in its JPMorgan Chase Bank, Countrywide Warehouse Lending and Residential Funding Corporation agreements. Each of the warehouse lenders has waived, for the period ending September 30, 2004, the covenants for which the Company was out of compliance.

In 2001, the Company also entered into a $5 million senior subordinated secured revolving loan agreement (Subordinated Loan Agreement). The Subordinated Loan Agreement bore an interest rate of 12%. The $3 million loan balance was paid off in full in April 2004. The agreement has since expired and the Company has no option to renew the agreement.

In April of 2004, the Company entered into agreements to sell approximately 85% of its mortgage portfolio assets. As a result, approximately $90 million in long-term debt was reclassified to short-term debt pending sale. During the second quarter of 2004 the Company extinguished all of the reclassified short-term debt, using proceeds from the sale of the related bond collateral mortgage loans and real estate owned bond collateral. As of September 30, 2004, all mortgage portfolio assets related to the April 2004 sale agreements have been sold.

Note 8. Long-Term Debt Related to Securitizations, net

The components of the long-term debt at September 30, 2004 and December 31, 2003, along with selected other information are summarized below (dollars in thousands) (unaudited):

	CMO/REMIC 2000-2 Securitization	CMO/REMIC 1999-A Securitization	CMO 1999-2 Securitization	CMO 1999-1 Securitization	CMO/FASIT 1998-1 Securitization	TOTAL Long-Term Debt
At September 30, 2004						
Long-term debt	$ 0	$ 0	$ 0	$ 0	$ 15,869	$ 15,869
Capitalized costs on long-term debt	0	0	0	0		
Total long-term debt	$ 0	$ 0	$ 0	$ 0	$ 15,869	$ 15,869
Weighted average financing rates	0%	0%	0%	0%	3.03%	3.03%
At December 31, 2003						
Long-term debt	$ 7,182	$ 33,012	$ 51,594	$ 16,753	$ 22,229	$ 130,770
Capitalized costs on long-term debt	(30)	(1)	(267)	(177)		(475)
Total long-term debt	$ 7,152	$ 33,011	$ 51,327	$ 16,576	$ 22,229	$ 130,295
Weighted average financing rates	2.24%	1.29%	3.33%	1.82%	2.14%	2.37%

Note 9. Stock Plans

At the annual meeting of shareholders held on August 12, 2004 there was majority approval for the creation of the 2004 Equity Incentive Plan. Approval of this plan authorized an additional 500,000 options to be granted combined with all ungranted options in the 1997 Stock Incentive Plan, 1997 Stock Option Plan and the 1997 Outside Director Stock Option Plan. The 1997 plans will cease to exist except for the 1997 Employee Stock Purchase Plan. As of September 30, 2004, shares of common stock were reserved for issuance under the Company s stock option plans as follows (unaudited):

	1997 Stock Incentive Plan	1997 Stock Option Plan	1997 Employee Stock Purchase Plan	1997 Outside Director Stock Option Plan	2004 Equity Incentive Plan	Total
Total Options Authorized at 1/1/2004	315,200	1,474,800	20,000	210,000		2,020,000
Total Options Issued at or by 8/12/04	284,800	1,459,393		179,500		1,923,693
Options Authorized at 8/12/04					500,000	500,000
Balance of Options Not Granted at 8/12/04	30,400	15,407	20,000	30,500	500,000	596,307
Balance of Options not Granted at 8/12/04 moved to 2004 Equity Incentive Plan	(30,400)	(15,407)		(30,500)	76,307	
Options Reserved For Issuance at 8/12/04			20,000		576,307	596,307
Cancellations 8/12/04 to 9/30/04		20,878				20,878
Cancellations 8/12/04 to 9/30/04 moved to 2004 Equity Incentive Plan		(20,878)			20,878	

Options Reserved For Issuance at 9/30/04	20,000	597,185	617,185

Stock option activity during the nine months ending September 30, 2004 was as follows (unaudited):

	Number of Options	Weighted-Average Exercise Price
Balance at December 31, 2003	1,768,100	$ 7.96
Granted	216,750	8.62
Forfeited	(113,259)	7.54
Exercised	(29,170)	5.42
Balance at September 30, 2004	1,842,421	$ 8.10

At September 30, 2004, the range of exercise prices for outstanding options was $1.75 to $15.00 and the weighted-average remaining contractual life of outstanding options was 6.26 years. The weighted average exercise price of exercisable outstanding options was $9.03. The table below shows options and prices for all outstanding options at September 30, 2004 (unaudited):

Option Exercise Price Range	Vested	Unvested	Number of Options
$1.75 to $3.00	110,035	61,799	171,834
$3.01 to $5.00	235,021	235,041	470,062
$5.01 to $7.50	307,136	43,314	350,450
$7.51 to $10.00	131,996	152,679	284,675