ACCREDITED HOME LENDERS HOLDING CO
Form 10-Q
November 15, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **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

¨ **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 0-50179

ACCREDITED HOME LENDERS HOLDING CO.

(Exact name of registrant as specified in its charter)

Delaware	**04-3669482**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

15090 Avenue of Science

San Diego, California 92128

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: 858-676-2100

Former name, former address and former fiscal year, if changed since last report: not applicable

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 x or No ¨

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

The number of outstanding shares of the registrant s common stock as of October 29, 2004 was 21,199,728.

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FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements. When used in this report, statements which are not historical in nature, including the words anticipate, estimate, should, expect, believe, intend and similar expressions are intended to identify forward-looking statements. Th include statements containing a projection of revenues, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this report are based upon our management s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to them. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us, that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition that we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

- changes in demand for, or value of, mortgage loans due to the attributes of the loans we originate; the characteristics of our borrowers; and fluctuations in the real estate market, interest rates or the market in which we sell or securitize our loans;
- a general deterioration in economic or political conditions;
- our ability to protect and hedge our mortgage loan portfolio against adverse interest rate movements;
- changes in government regulations that affect our ability to originate and service mortgage loans;
- changes in the credit markets, which affect our ability to borrow money to originate mortgage loans;
- the degree and nature of our competition;
- our ability to employ and retain qualified employees; and
- the other factors referenced in this report, including, without limitation, under the section entitled ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors.

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In this Form 10-Q, unless the context requires otherwise, Accredited, Company, we, our, and us means Accredited Home Lenders Holding Co. and its subsidiaries.

PART I

Item 1. ***Financial Statements***

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(dollars in thousands)	December 31, 2003	September 30, 2004
ASSETS		
Cash and cash equivalents	$ 27,119	$ 73,469
Restricted cash	209	5,690
Mortgage loans held for sale, net of market reserve of $12,213 and $14,372, respectively	1,277,075	1,848,376
Mortgage loans held for investment, net of allowance for loan losses of $19,890 and $51,328, respectively	2,090,237	4,047,046
Mortgage-related securities, at fair value	3,692	3,754
Mortgage servicing rights, net	1,119	331
Furniture, fixtures and equipment, net	20,674	32,653
Other receivables	44,911	60,570
Prepaid income taxes		19,878
Deferred income tax asset	16,052	17,214
Prepaid expenses and other assets	20,329	27,693
TOTAL	$ 3,501,417	$ 6,136,674
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Warehouse facilities	$ 1,515,195	$ 2,411,415
Securitization bond financing	1,724,389	3,275,887
Income taxes payable	2,949	
Accounts payable and accrued liabilities	46,661	50,975
Total liabilities	3,289,194	5,738,277
COMMITMENTS AND CONTINGENCIES (Note 14)		
MINORITY INTEREST IN SUBSIDIARY		84,094
STOCKHOLDERS EQUITY:		
Preferred stock, $.001 par value; authorized 5,000,000 shares; no shares issued and outstanding		

Common stock, $.001 par value; authorized 40,000,000 shares; issued and outstanding 20,366,314 shares at December 31, 2003 and 21,161,641 shares at September 30, 2004 (including 326,113 and 563,767, respectively, of restricted stock awarded under the deferred compensation plan)	20	21
Additional paid-in capital	61,585	78,970
Note receivable for common stock	(1,250)	(1,250)
Unearned compensation	(5,623)	(11,685)
Other comprehensive loss		(1,921)
Retained earnings	157,491	250,168
Total stockholders equity	212,223	314,303
TOTAL	$ 3,501,417	$ 6,136,674

See notes to condensed consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(dollars and shares outstanding in thousands, except for earnings per share)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
REVENUES:				
Interest income	$ 47,870	$ 97,493	$ 120,484	$ 242,792
Gain on sale of loans (including $0, $0, $2,834 and $0, respectively, with a related party)	65,237	77,993	171,317	210,342
Loan servicing income	1,979	1,996	5,789	5,205
Net gain on mortgage-related securities and derivatives	1,051	309	5,439	2,083
Other income	98	283	583	413
Total revenues	116,235	178,074	303,612	460,835
EXPENSES:				
Salaries, wages and benefits	28,700	42,674	79,523	117,775
Interest expense (including $0, $0, $597 and $0, respectively, with a related party)	16,616	37,114	43,628	86,137
Occupancy	3,449	4,810	8,448	13,341
Provision for losses	6,537	14,416	22,916	39,708
Depreciation and amortization	1,260	2,911	3,343	6,934
General and administrative expenses	10,590	15,878	29,019	42,002
Total expenses	67,152	117,803	186,877	305,897
INCOME BEFORE INCOME TAXES	49,083	60,271	116,735	154,938
INCOME TAXES	19,634	23,234	46,694	61,101
MINORITY INTEREST DIVIDENDS ON PREFFERED STOCK OF SUBSIDIARY		1,160		1,160
NET INCOME	$ 29,449	$ 35,877	$ 70,041	$ 92,677
BASIC EARNINGS PER SHARE	$ 1.50	$ 1.75	$ 4.09	$ 4.57
DILUTED EARNINGS PER SHARE	$ 1.40	$ 1.66	$ 3.56	$ 4.31
WEIGHTED AVERAGE SHARES OUTSTANDING:				
BASIC	19,651	20,470	17,139	20,287
DILUTED	21,046	21,580	19,687	21,516

See notes to condensed consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(dollars in thousands)	Nine Months Ended September 30, 2003	Nine Months Ended September 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 70,041	$ 92,677
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	3,343	6,934
Amortization of unearned compensation	406	2,473
Loss on disposal of furniture, fixtures, and equipment	120	39
Mortgage loans held for sale originated, net of fees	(4,467,876)	(6,076,570)
Proceeds from sale of mortgage loans held for sale, net of fees	4,223,016	5,789,582
Collection of principal payments on mortgage loans held for sale	22,902	52,405
Net change in fair value hedge basis adjustment on mortgage loans held for sale and securitized loans	(10,769)	(16,910)
Amortization of net deferred origination fees on securitized loans	(447)	1,972
Cash received on mortgage-related securities	11,205	2,419
Net unrealized gain on mortgage-related securities	(6,513)	(2,086)
Accretion of mortgage-related securities	(671)	(380)
Amortization of mortgage servicing rights	1,598	788
Provision for losses	22,916	39,708
Deferred income taxes	(2,743)	(1,162)
Income tax deduction for disqualifying stock dispositions		5,625
Changes in assets and liabilities:		
Other receivables	(15,510)	(15,659)
Prepaid income taxes		(19,878)
Other assets	2,442	(2,642)
Accounts payable and accrued liabilities	10,262	3,691
Income taxes payable	(998)	(2,949)
Net cash used in operating activities	(137,276)	(139,923)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(11,398)	(18,952)
Mortgage loans held for investment originated	(1,140,347)	(2,905,882)
Principal payments on securitized loans	119,857	581,562
Net cash used in investing activities	(1,031,888)	(2,343,272)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from warehouse credit facilities	569,573	896,220
Payments of borrowings on residual interest credit facility	(6,859)	
Proceeds from issuance of securitization bond financing	719,847	2,167,569
Payments of securitization bond financing.	(141,289)	(616,071)
Change in restricted cash	(1,367)	(5,481)
Payments on capital leases	(208)	(12)
Proceeds from exercise of stock options	547	1,123
Proceeds from issuance of stock under ESPP	1,873	2,103
Net proceeds from initial public offering and concurrent private placement	38,294	
Proceeds from preferred stock offering of consolidated subsidiary		84,094

Net cash provided by financing activities	1,180,411	2,529,545
NET INCREASE IN CASH AND CASH EQUIVALENTS	11,247	46,350
BEGINNING BALANCE, CASH AND CASH EQUIVALENTS	11,300	27,119
ENDING BALANCE, CASH AND CASH EQUIVALENTS	$ 22,547	$ 73,469
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 38,960	$ 74,772
Income taxes	$ 50,359	$ 78,194
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of loans held for sale to loans held for investment	$ 720,940	$ 2,570,380
Transfer of loans held for sale to real estate owned, included in other assets	$ 7,347	$ 4,721
Transfer of mortgage related securities from other liabilities	$	$ 16
Unearned compensation	$ 284	$ 129
Deferred compensation	$	$ 8,406
Conversion of convertible debt to common stock	$ 3,000	$
Conversion of preferred stock to common stock	$ 5,113	$
Conversion of warrants to common stock	$ 1	$

See notes to condensed consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(unaudited)

	Common Stock		Additional Paid-in	Note Receivable for Common	Unearned	Other Comprehensive	Retained	
	Shares	Amount	Capital	Stock	Compensation	Loss	Earnings	Total
				(dollars in thousands)				
BALANCE, JANUARY 1, 2003	5,833,873	$ 6	$ 2,351	$ (1,250)	$ (574)	$	$ 57,476	$ 58,009
Issuance of common stock for options exercised	517,546	1	864					865
Issuance of common stock in initial public offering and concurrent private placement, net of offering costs	5,653,712	6	38,288					38,294
Conversion of preferred stock, convertible debt and warrants to common stock	7,631,191	7	8,106					8,113
Issuance of common stock in the employee stock purchase plan	403,879		4,045					4,045
Stock compensation related to non-employee stock options			434		(434)			
Amortization of unearned compensation					282			282
Issuance and amortization of restricted stock net of forfeited shares	326,113		5,415		(4,897)			518
Tax benefit for disqualifying stock dispositions			2,082					2,082
Net income							100,015	100,015
BALANCE, DECEMBER 31, 2003	20,366,314	$ 20	$ 61,585	$ (1,250)	$ (5,623)		$ 157,491	$ 212,223
Issuance of common stock for options exercised	469,797	1	1,122					1,123
Issuance of common stock in the employee stock purchase plan	87,876		2,103					2,103
Stock compensation related to non-employee stock options			129		(129)			
Amortization of unearned compensation					274			274
Issuance and amortization of restricted stock net of forfeited shares	237,654		8,406		(6,207)			2,199
Tax benefit for disqualifying stock dispositions			5,625					5,625
Other comprehensive loss, net of tax						(1,921)		(1,921)
Net income							92,677	92,677
BALANCE, September 30, 2004	21,161,641	$ 21	$ 78,970	$ (1,250)	$ (11,685)	$ (1,921)	$ 250,168	$ 314,303

See notes to condensed consolidated financial statements.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For The Nine Months Ended September 30, 2003 and 2004 (Unaudited)

1. THE COMPANY AND A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The consolidated financial statements include the accounts of Accredited Home Lenders Holding Co. (AHLHC), a Delaware corporation, and its wholly owned subsidiaries Accredited Home Lenders, Inc. (AHL), AHL s wholly owned subsidiary Accredited Mortgage Loan REIT Trust (REIT) and the recently formed subsidiary Accredited Home Lenders Canada, Inc. (collectively the Company). REIT was formed in May 2004 as a Maryland real estate investment trust for the purpose of acquiring, holding and managing real estate assets. The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America 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 nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. All intercompany balances and transactions have been eliminated. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in AHLHC s Annual Report on Form 10-K for the year ended December 31, 2003.

On February 14, 2003, AHLHC completed an initial public offering (the Offering) whereby 9,650,000 shares of its common stock (of which 4,493,022 shares were offered by AHLHC) were sold to the public resulting in gross proceeds of $35.9 million to AHLHC. In addition, AHLHC sold 510,697 shares of its common stock in a concurrent private placement resulting in gross proceeds of $3.8 million to AHLHC. Concurrently, 5,893,546 shares of common stock of AHLHC were issued in exchange for all of the issued and outstanding shares of common stock of AHL as part of a reorganization whereby AHL became a wholly owned subsidiary of AHLHC. The acquisition of AHL has been accounted for at historical cost in a manner similar to a pooling of interests, and the accompanying consolidated financial statements have been prepared assuming the reorganization had occurred as of the first day of the earliest period presented herein. The consolidated financial position and results of operations of the Company for the periods prior to the date of the reorganization consist of those of AHL.

On March 18, 2003, the underwriters of the Company s Offering purchased an additional 907,500 shares of common stock (of which 649,993 shares were offered by the Company) at $7.44 per share upon partial exercise of their over-allotment option pursuant to the Offering, resulting in gross proceeds of $4.8 million to the Company.

In August 2004, REIT completed a public offering of 3,400,000 Series A Preferred Shares, and in September 2004 sold an additional 100,000 Series A Preferred Shares pursuant to the exercise of the underwriters over-allotment option. The sale of the 3,500,000 Series A Preferred Shares resulted in gross proceeds of $87.5 million to REIT. In October 2004, REIT closed the public offering of 593,678 additional Series A Preferred Shares. The sale resulted in an additional $15.0 million of gross proceeds to REIT.

General The Company engages in the business of originating, financing, securitizing, selling and servicing non-prime mortgage loans secured by residential real estate. The Company focuses on borrowers who may not meet conforming underwriting guidelines because of higher loan-to-value ratios, the nature or absence of income documentation, limited credit histories, high levels of consumer debt, or past credit difficulties. The Company originates loans primarily based upon the borrower s willingness and ability to repay the loan and the adequacy of the collateral.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Cash Cash held on behalf of employees for the Employee Stock Purchase Plan and flexible spending accounts is classified as restricted cash. In addition, the Company has deposited $4.2 million in a bank account to cover the risk of loss on its errors and omissions liability insurance coverage.

Mortgage Banking Activities The Company derives its revenue from the interest earned on mortgage loans and from the sale of loans to various third-party investors under purchase and sale agreements. Loan sales may be either on a servicing retained or released basis, and may take the form of a securitization. The Company may also retain interest-only strips or the right to other excess cash flows. Gains or losses resulting from loan sales are recognized at the time of sale, based on the difference between the net sales proceeds, including retained interests, and the allocated book value of the loans sold.

In the past, the Company has entered into securitizations structured as sales and retained a residual interest. The Company also sold loans to a third-party securitizer and retained the right to receive future payments based upon certain excess cash flows (primarily excess interest or prepayment penalties) generated by such loans. The revenue recognized from such transactions included an adjustment for such residual interests or excess cash flows (collectively, mortgage-related securities) based upon the net present value of the amount expected to be received from the underlying loans less amounts paid to investors, estimated credit losses, servicing fees, as well as mortgage insurance fees, guarantee fees, and trustee fees for the securitizations. The net present value of the mortgage-related securities is determined based on assumptions for loan prepayments, defaults and other factors that market participants would demand for such financial instruments.

The Company measures mortgage-related securities like debt securities classified as trading securities under Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, mortgage-related securities are recorded at fair value with any unrealized gains or losses recorded in the results of operations in the period of change in fair value. The Company determines the fair value of mortgage-related securities at origination and at each reporting period by discounting the estimated net future cash flows using assumptions that market participants would use to estimate fair value, including assumptions about interest rates, credit losses, and prepayment speeds. To the Company s knowledge, there is no active market for the sale of such mortgage-related securities; accordingly, the Company s estimate of fair value is subjective.

In the ordinary course of business, an investor may request that the Company refund a portion of the premium paid on the sale of mortgage loans if a loan is prepaid in full within a certain amount of time from the date of sale. The Company records a reserve for estimated premium recapture on loans sold, which is charged to gain on sale of loans.

Securitized Loans and Securitization Bond Financing Since July 2002, the Company has completed a total of eight securitizations totaling $ 4.2 billion structured as a financing under Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125*.

These securitizations are structured legally as sales, but for accounting purposes are treated as financings under SFAS No. 140. These securitizations do not meet the qualifying special purpose entity criteria under SFAS No. 140 and related interpretations because after the loans are securitized, the securitization trusts may acquire derivatives relating to beneficial interests retained by the Company and, the Company, as servicer, subject to applicable contractual provisions, has discretion, consistent with prudent mortgage servicing practices, to determine whether to sell or work out any loans securitized through the securitization trusts that become troubled. Accordingly, the loans remain on the balance sheet (referred to as securitized loans), retained interests are not created, and securitization bond financing replaces the warehouse debt originally associated with

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the securitized loans. The Company records interest income on securitized loans and interest expense on the bonds issued in the securitizations over the life of the securitizations. Deferred debt issuance costs and discount related to the bonds are amortized on a level yield basis over the estimated life of the bonds.

The Company periodically evaluates the need for or the adequacy of the allowance for loan losses on its securitized loans and loans held for securitization. Provision for loan losses on securitized loans and loans held for securitization is made in an amount sufficient to maintain credit loss allowances at a level considered appropriate to cover probable losses in such portfolio. The Company defines a loan as impaired at the time the loan becomes 90 days or more delinquent under its payment terms. Probable losses are determined based on segmenting the portfolio relating to their contractual delinquency status and applying the Company s historical loss experience. The Company also uses other analytical tools to determine the reasonableness of the allowance for loan losses. Loss estimates are reviewed periodically and adjustments are reported in earnings. As these estimates are influenced by factors outside of the Company s control, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Carrying values are written down to fair value when the loan is foreclosed or deemed uncollectible.

Mortgage loans held for investment Both securitized loans and loans held for securitization are classified as mortgage loans held for investment. The loans held for securitization are carried at the lower of aggregate cost (including hedge basis adjustments) or market. See discussion above for securitized loans.

Derivative Financial Instruments As part of the Company s interest rate management process, the Company uses derivative financial instruments such as Eurodollar futures and options. In connection with five of the securitizations structured as financings, the Company entered into interest rate cap agreements. It is not the Company s policy to use derivatives to speculate on interest rates. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, derivative financial instruments are reported on the consolidated balance sheets at their fair value.

The Company designates certain derivative financial instruments as hedge instruments under SFAS No. 133, and, at trade date, these instruments and their hedging relationship are identified, designated and documented. For derivative financial instruments designated as hedge instruments, the Company evaluates the effectiveness of these hedges against the mortgage loans being hedged to ensure that there remains adequate correlation in the hedge relationship. To hedge the adverse effect of interest rate changes on the fair market value of mortgage loans held for sale, the Company is using derivatives as fair value hedges under SFAS No. 133. Once the hedge relationship is established, the realized and unrealized changes in fair value of both the hedge instruments and mortgage loans are recognized in the consolidated statement of operations in the period in which the changes occur. Any change in the fair value of mortgage loans held for sale recognized as a result of hedge accounting is reversed at the time the mortgage loans are sold. The net amount recorded in the consolidated statement of operations is referred to as hedge ineffectiveness. During the third quarter 2004, the Company implemented the use of cash flow hedging on its securitized loans under SFAS No. 133. Pursuant to SFAS No. 133 hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitized loans attributable to interest rate risk. 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 as a component of other comprehensive income in stockholders equity, and reclassified into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. The ineffective portion on the derivative instrument is reported in current earnings as a component of interest expense.

For derivative financial instruments not designated as hedge instruments, realized and unrealized changes in fair value are recognized in the consolidated statements of operations in the period in which the changes occur.

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Provision for Losses Market valuation adjustments have been provided on certain nonperforming loans, other loans held for sale and real estate owned. These adjustments are based on the Company s estimate of expected losses, calculated using loss severity and loss frequency rate assumptions, and are based on the value that the Company could reasonably expect to obtain from a sale, that is, other than in a forced or liquidation sale. Provision for losses on securitized loans is recorded in an amount sufficient to maintain the allowance for loan losses at a level considered appropriate to cover probable losses on such loans. Provision for losses also includes net losses on real estate owned. The Company also accrues liabilities associated with loans sold which may be required to be repurchased due to breaches of representations and warranties and early payment defaults. The Company periodically evaluates the estimates used in calculating expected losses and adjustments are reported in earnings. As these estimates are influenced by factors outside of the Company s control and as uncertainty is inherent in these estimates, it is reasonably possible that they could change.

Escrow and Fiduciary Funds The Company maintains segregated bank accounts in trust for investors with respect to payments on securitized loans and mortgage loans serviced for investors, as well as for mortgagors with respect to property tax and hazard insurance premium payments escrowed by mortgagors with the Company. Such accounts amounted to $35.4 million and $78.4 million at December 31, 2003 and September 30, 2004, respectively, and are excluded from the Company s assets and liabilities.

Stock-Based Compensation SFAS No. 123, *Accounting for Stock-Based Compensation*, encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value.

The Company has been accounting for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the fair value of the Company s stock at the date of grant over the grant price.

The Company has adopted the disclosure only provisions of SFAS No. 123. Had compensation cost for the Company s stock-based compensation plans been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company s net income would have been reduced to the pro forma amounts as follows (dollars in thousands):

	Three Months Ended September 30,	
	2003	**2004**
Net income, as reported	$ 29,449	$ 35,877
Add: Stock-based compensation included in reported net income, net of tax		85
Deduct: Stock-based employee compensation expense determined using fair value method, net of tax	(85)	(491)
Pro forma net income	$ 29,364	$ 35,471

Earnings per share:		
Basic as reported	$ 1.50	$ 1.75
Basic pro forma	$ 1.49	$ 1.73
Diluted as reported	$ 1.40	$ 1.66
Diluted pro forma	$ 1.40	$ 1.64

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Nine Months Ended September 30,	
	2003	2004
Net income, as reported	$ 70,041	$ 92,677
Add: Stock-based compensation included in reported net income, net of tax		164
Deduct: Stock-based employee compensation expense determined using fair value method, net of tax	(187)	(1,473)
Pro forma net income	$ 69,854	$ 91,368
Earnings per share:		
Basic as reported	$ 4.09	$ 4.57
Basic pro forma	$ 4.08	$ 4.50
Diluted as reported	$ 3.56	$ 4.31
Diluted pro forma	$ 3.55	$ 4.25

The fair value of each option grant is estimated as of the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: no dividends, an expected option life of five years, a risk-free rate of 3.0% and 3.4% (nine months ended September 30, 2003 and 2004, respectively) and a 48.8% and 54.5% weighted average volatility (nine months ended September 30, 2003 and 2004, respectively). The Company s volatility is calculated as an average of its own volatility and the mean of its closest competitors volatility for the respective periods due to the limited period of time since the Offering. The weighted average fair value at grant date was $6.81 and $17.98 for options granted during the nine months ended September 30, 2003 and 2004, respectively.

Segment Reporting While the Company s management monitors the revenue streams through wholesale and retail loan originations, operations are managed and financial performance is evaluated by the Company s chief operating decision-maker on a company-wide basis. The Company has identified REIT and AHL as separate operating segments, however they are aggregated to a single reporting segment for financial reporting due to commonality and similarity of operations. See Note 15 for supplemental condensed consolidating financial information.

Use of Estimates in the Preparation of Financial Statements The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the valuation of the mortgage-related securities, mortgage servicing rights, derivative financial instruments and hedged assets, the determination of the market reserve on loans and the allowance for loan losses on securitized loans and loans held for investment, and the determination of the reserves for repurchases.

Reclassifications Certain items in the prior year financial statements have been reclassified to conform to the current year presentation.

Recent Accounting Developments In March 2004, the Securities and Exchange Commission issued Staffing Accounting Bulletin No. 105 (SAB No. 105). SAB No. 105 contains specific guidance that significantly limits opportunities for registrants to recognize an asset related to a commitment to originate a mortgage loan that will be held for sale prior to funding the loan, which differs from the current accounting guidance provided by Statement of Financial Accounting Standards No. 149 (SFAS No. 149). SFAS No. 149 requires that the entity that makes the mortgage loan commitment record the commitment on its balance sheet at

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

fair value, but does not address how to measure the fair value of the loan commitment. SAB No. 105 requires that fair value measurement of loan commitments include only differences between the guaranteed interest rate in the loan commitment and a market interest rate, excluding any expected cash flows related to the customer relationship or loan servicing. SAB No. 105 is effective for new loan commitments accounted for as derivatives entered into after March 31, 2004. SAB No.105 permits registrants to continue to use previously applied accounting policies to commitments entered into on or before March 31, 2004. We quote interest rates to borrowers, which are generally subject to change by us. Although we typically honor such interest rate quotes, the quotes do not constitute interest rate locks, minimizing the potential interest rate exposure. We do not account for our interest rate quotes as derivatives. We do not expect that the application of SAB No. 105 will have a material impact on our consolidated financial statements.

2. CONCENTRATIONS OF RISK

The Company s ability to continue to originate and purchase loans is dependent, in part, upon its ability to securitize and sell loans in the secondary market in order to generate cash proceeds for new originations and purchases. The value of and market for the Company s loans are dependent upon a number of factors, including general economic conditions, interest rates and governmental regulations. Adverse changes in such factors may affect the Company s ability to securitize or sell loans for acceptable prices within reasonable periods of time.

Geographical Concentration Properties securing the mortgage loans in the Company s servicing portfolio, including loans subserviced, are geographically dispersed throughout the United States. At September 30, 2003 and 2004, approximately 34% and 33%, respectively, of the properties were located in California. The remaining properties securing mortgage loans serviced did not exceed 10% in any other state at any period end.

Loan originations are geographically dispersed throughout the United States. During the nine months ended September 30, 2003 and 2004, approximately 33% and 29%, respectively, of the principal balance of loans originated were collateralized by properties located in California. The remaining originations did not exceed 10% in any other state during any of such periods.

3. MORTGAGE LOANS

Mortgage loans held for sale Mortgage loans held for sale were as follows (dollars in thousands):

	December 31, 2003	September 30, 2004
Mortgage loans held for sale principal balance	$ 1,288,630	$ 1,853,673

Basis adjustment for fair value hedge accounting	(1,368)	6,791
Net deferred origination costs	2,026	2,284
Market reserve	(12,213)	(14,372)
Mortgage loans held for sale, net	$ 1,277,075	$ 1,848,376

Mortgage loans held for investment Mortgage loans held for investment were as follows (dollars in thousands):

	December 31, 2003	**September 30, 2004**
Mortgage loans held for investment principal balance	$ 2,095,398	$ 4,083,987
Basis adjustment for fair value hedge accounting	17,302	19,276
Net deferred origination fees	(2,573)	(4,889)
Allowance for loan losses	(19,890)	(51,328)
Mortgage loans held for investment, net	$ 2,090,237	$ 4,047,046

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2003 and September 30, 2004, mortgage loans held for investment included unpaid principal balance of $334.3 million and $681.5 million, respectively, in loans held for a securitization.

Provision for losses Activity in the market reserve on loans held for sale was as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Balance, beginning of period	$ 11,634	$ 13,698	$ 6,885	$ 12,213
Provision for losses	3,013	1,281	10,799	4,942
Chargeoffs, net	(2,206)	(607)	(5,243)	(2,783)
Balance, end of period	$ 12,441	$ 14,372	$ 12,441	$ 14,372
Reserve % of loans held for sale	0.91%	0.78%	0.91%	0.78%

Activity in the allowance for loan losses on mortgage loans held for investment was as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Balance, beginning of period	$ 10,330	$ 40,080	$ 4,550	$ 19,890
Provision for losses	4,327	11,806	10,107	32,498
Chargeoffs, net	(107)	(558)	(107)	(1,060)
Balance, end of period	$ 14,550	$ 51,328	$ 14,550	$ 51,328
Allowance % of mortgage loans held for investment	0.92%	1.26%	0.92%	1.26%

As of December 31, 2003 and September 30, 2004, $7.5 million and $18.5 million of mortgage loans held for investment were 90 days or more delinquent under their payment terms, respectively. This increase results from the increased age and size of the Company s securitized loan portfolio.

As of December 31, 2003 and September 30, 2004, $4.2 million and $2.3 million of real estate owned, net of the reserve for losses on real estate owned of $1.7 million and $1.0 million, respectively, is included in other assets. Activity in the reserve for losses on real estate owned was as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Balance, beginning of period	$ 1,733	$ 1,171	$ 2,092	$ 1,684
Provision for (recovery of) losses	(61)	669	340	1,197
Chargeoffs, net	59	(833)	(701)	(1,874)
Balance, end of period	$ 1,731	$ 1,007	$ 1,731	$ 1,007

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Provision for losses in the accompanying consolidated statements of operations is composed of the following (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Provision allowance for losses on mortgage loans held for investment	$ 4,327	$ 11,806	$ 10,107	$ 32,498
Provision market reserve on loans	3,013	1,281	10,799	4,942
Provision (recovery) reserve for real estate owned	(61)	669	340	1,197
Provision (recovery) reserve for repurchases	(616)	476	1,087	811
Net losses (gains) on real estate owned	(126)	184	583	260
	$ 6,537	$ 14,416	$ 22,916	$ 39,708

4. MORTGAGE-RELATED SECURITIES

Mortgage-related securities consisted of the following (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Balance, beginning of period	$ 6,335	$ 3,865	$ 8,356	$ 3,692
Net unrealized gains	1,400	457	6,513	2,086
Interest accretion	150	146	671	379
Cash collected	(3,550)	(187)	(11,205)	(2,419)
Reclassification to other liabilities		(527)		16
Balance, end of period	$ 4,335	$ 3,754	$ 4,335	$ 3,754

The Company utilized the following assumptions to revalue all mortgage-related securities that arose from sales of loans by the Company to third party investors outstanding at December 31, 2003 and September 30, 2004 (dollars in thousands):

	December 31, 2003	September 30, 2004
Annual prepayment speeds	20.0% to 67.5%	20.0% to 65.0%
Discount rate	15%	15%
Expected cumulative credit losses	4.2%	4.1%
Interest rates on adjustable rate loans	Forward LIBOR curve	Forward LIBOR curve
Fair value at period end	$(297)	$(313)

The fair value of the mortgage-related securities that arose from the sales of loans to a third party investor (a former related party) of ($297,000) and ($313,000) at December 31, 2003 and September 30, 2004, respectively, is included in other liabilities on the balance sheet.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company utilized the following assumptions to revalue all mortgage-related securities that arose from the Company s 2000 securitization outstanding at December 31, 2003 and September 30, 2004 (dollars in thousands):

	December 31, 2003	September 30, 2004
Annual prepayment speeds	22.0% to 55.2%	22.0% to 38.0%
Discount rate	15%	15%
Expected cumulative credit losses	4.9%	4.2%
Interest rates on adjustable rate loans	Forward LIBOR curve	Forward LIBOR curve
Fair value at period end	$3,692	$3,754

5. MORTGAGE SERVICING RIGHTS

The Company recognizes as a separate asset the rights to service mortgage loans for others once such rights are contractually separated from the underlying loans. Mortgage servicing rights are amortized in proportion to and over the period of the estimated net servicing income and are recorded at the lower of amortized cost or fair value.

Mortgage servicing rights were as follows (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Balance, beginning of period	$ 2,005	$ 542	$ 3,116	$ 1,119
Amortization	(487)	(211)	(1,598)	(788)
Balance, end of period	$ 1,518	$ 331	$ 1,518	$ 331

The fair value of mortgage servicing rights at September 30, 2003 and September 30, 2004 was $1.8 million and $342,000, respectively.

The Company periodically evaluates mortgage servicing rights for impairment, which is measured as the excess of cost over fair value. This review is performed on a disaggregated basis based on loan type using prepayment assumptions ranging from 20.0% to 67.5% and 20.0% to 65.0% for December 31, 2003 and September 30, 2004, respectively, and a discount rate of 15% at both December 31, 2003 and September 30, 2004. Impairment, if it occurs, is recognized in a valuation allowance for each pool in the period of impairment. No impairment was identified as of December 31, 2003. As of September 30, 2004, $39,000 of impairment was recognized.

As of September 30, 2003 and 2004, the unpaid principal balance of loans sold servicing retained was $362.8 million and $200.4 million, respectively.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative Financial Instruments and Hedged Instrument Activity The Company uses hedge accounting as defined by SFAS No. 133 for certain derivative financial instruments used to hedge its mortgage loans held for sale. At December 31, 2003 and September 30, 2004, fair value hedge basis adjustments of ($1.4) million and $6.8 million, respectively, are included in mortgage loans held for sale related to the $762.9 million and $931.9 million, respectively, of such loans designated as hedged assets. Hedge ineffectiveness associated with fair value hedges of ($1.5 million) and ($336,000) was recorded in earnings during the three and nine months ended September 30, 2004, respectively, and is included in gain on sale of loans in the consolidated statements of operations. The effective portion of this hedging is also recorded, but by definition has a neutral impact.

The Company uses hedge accounting as defined by SFAS No. 133 for certain derivative financial instruments used to hedge its loans held for investment. At December 31, 2003 and September 30, 2004, fair value hedge basis adjustments of $17.3 million and $19.3 million, respectively, are included in loans held for investment related to the $1.2 billion and $2.7 billion, respectively, of such loans designated as hedged assets. During the third quarter 2004, the Company implemented the use of cash flow hedging on its securitized loans under SFAS No. 133. Previously, the Company had been using fair value hedge accounting, but elected to use this alternative method to accommodate elements of the REIT requirements. The net impact on earnings is not expected to be materially different under the two methods. Pursuant to SFAS No. 133 hedge instruments have been designated as hedging the exposure to variability of cash flows from our securitized loans attributable to interest rate risk. Cash flow hedge accounting requires 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, while the ineffective portion is reported in current earnings. Hedge effectiveness associated with cash flow hedges of ($1.9) million, net of tax, was recorded in other comprehensive loss during both the three and nine months ended September 30, 2004 and is included as a component of stockholders equity. This effective portion will be reclassified into earnings in the period during which the hedged transaction affects earnings pursuant to SFAS No. 133. Hedge ineffectiveness associated with cash flow hedges of ($204) thousand was recorded in earnings during both the three and nine months ended September 30, 2004, and is included as a component of interest expense in the consolidated statements of operations. Hedge ineffectiveness associated with fair value hedges of ($175,000) and ($748,000) was recorded in earnings during the three and nine months ended September 30, 2004 and is included as a reduction in interest income in the consolidated statements of operations.

At September 30, 2004, the Company had outstanding futures contracts with a fair value of ($3.9) million included in accrued liabilities of which contracts with a fair value of ($3.9) million are designated as hedge instruments. The Company is required to maintain a cash deposit in a margin account with its broker related to these derivative transactions. At September 30, 2004, approximately $21.4 million was on deposit in such margin account, which is included in other receivables. Accordingly, the net liquidation value of the Company s derivative financial instruments and related margin account is $17.5 million at September 30, 2004. In addition, the Company had option contracts and interest rate cap agreements with a fair value of $687,000 and $1.3 million, respectively, included in other assets at September 30, 2004.

At December 31, 2003, the Company had outstanding futures contracts with a fair value of ($9.4) million included in accrued liabilities of which contracts with a fair value of ($8.9) million are designated as hedge instruments. The Company is required to maintain a cash deposit in a margin account with its broker related to these derivative transactions. At December 31, 2003, approximately $20.4 million was on deposit in such margin account, which is included in other receivables. Accordingly, the net liquidation value of the Company s derivative financial instruments and related margin account is $11.0 million at December 31, 2003. In addition, the Company had option contracts and interest rate cap agreements with a fair value of $715,000 and $160,000, respectively, included in other assets at December 31, 2003.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The effect of the change in fair value of derivative financial instruments and the related hedged asset recorded in the various statement of operation line items are detailed below (dollars in thousands). The following table is not representative of our hedge ineffectiveness as it excludes the income statement effects attributable to fluctuations in interest rates that have been recognized in premiums on whole loans sales and interest margins.

	Three Months Ended September 30, 2003				
	Interest Income	Gain on Sale	Net Gain (Loss) on MRS	Interest Expense	Total
Net unrealized gain (loss)	$ (624)	$ (3,582)	$ 395	$	$ (3,811)
Net realized gain (loss)	618	5,291	(744)		5,165
Total	$ (6)	$ 1,709	$ (349)	$	$ 1,354

	Three Months Ended September 30, 2004				
	Interest Income	Gain on Sale	Net Gain (Loss) on MRS	Interest Expense	Total
Net unrealized gain (loss)	$ (1,859)	$ 23,834	$ 9	$ (204)	$ 21,780
Net realized loss	(886)	(23,012)	(157)		(24,055)
Total	$ (2,745)	$ 822	$ (148)	$ (204)	$ (2,275)

	Nine Months Ended September 30, 2003				
	Interest Income	Gain on Sale	Net Gain (Loss) on MRS	Interest Expense	Total
Net unrealized gain (loss)	$ (1,656)	$ 541	$ 3,680	$	$ 2,565

Net realized loss	(2,315)	(9,119)	(4,754)		(16,188)
Total	$ (3,971)	$ (8,578)	$ (1,074)	$	$ (13,623)

	Nine Months Ended September 30, 2004				
	Interest Income	Gain on Sale	Net Gain (Loss) on MRS	Interest Expense	Total
Net unrealized gain (loss)	$ (4,269)	$ 18,925	$ 615	$ (204)	$ 15,067
Net realized loss	(3,578)	(17,671)	(617)		(21,866)
Total	$ (7,847)	$ 1,254	$ (2)	$ (204)	$ (6,799)

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. CREDIT FACILITIES

Credit Facilities The Company had in place the following credit facilities:

	Amount Outstanding	
	December 31, 2003	September 30, 2004
A $500 million combined warehouse credit facility expiring July 30, 2005, collateralized by performing, aged and delinquent loans and REO property, bearing interest based on one-month LIBOR (rate was 3.1% to 5.3% at September 30, 2004).	$ 387.9 million	$ 419.5 million
A $650 million warehouse credit facility expiring May 27, 2005, collateralized by performing, aged and delinquent loans, bearing interest based on one-month LIBOR (rate was 3.2% to 3.4% at September 30, 2004).	$ 190.3 million	$ 470.2 million
A $40 million warehouse credit facility expiring August 31, 2005, collateralized by performing loans, bearing interest based on one-month LIBOR (rate was 5.25% at September 30, 2004).	$ 11.0 million	$ 10.8 million
A $450 million warehouse credit facility expiring April 18, 2005, collateralized by performing, aged and delinquent loans, bearing interest based on one-month LIBOR (rate was 3.0% to 4.1% at September 30, 2004). In November 2004, the credit facility was expanded to $600 million and the expiration date was extended to November 7, 2005.	$ 152.4 million	$ 244.6 million
A $150 million non-discretionary; $150 million discretionary warehouse credit facility expiring November 12, 2004, collateralized by performing, aged and delinquent loans, bearing interest based on one-month LIBOR (rate was 3.0% to 4.6% at September 30, 2004). In October 2004, the discretionary portion of the credit facility was expanded to $350 million and the expiration date was extended to November 30, 2004.	$ 168.4 million	$ 266.4 million
A $400 million warehouse credit facility expiring April 20, 2005, collateralized by performing, aged and delinquent loans, bearing interest based on one-month LIBOR (rate was 3.1% to 4.3% at September 30, 2004). In October 2004, the credit facility was expanded to $600 million.	$ 175.0 million	$ 296.0 million
A $500 million warehouse credit facility expiring October 8, 2004, collateralized by performing, aged and delinquent loans, bearing interest based on one-month LIBOR (rate was 2.7% to 3.3% at September 30, 2004). In October 2004, the credit facility expiration date was extended to October 7, 2005.	$ 214.7 million	$ 409.0 million
A $300 million warehouse credit facility expiring January 31, 2005, collateralized by performing, aged and delinquent loans and REO property, bearing interest based on one-month LIBOR (rate was 3.1% to 4.8% at September 30, 2004).	$ 215.5 million	$ 294.9 million
Total warehouse credit facilities	$ 1,515.2 million	$ 2,411.4 million

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of September 30, 2004, the Company was in compliance with all covenant requirements for each of the facilities. The Company s warehouse and other credit facilities contain customary covenants including minimum liquidity, profitability and net worth requirements and limitations on other indebtedness. If the Company fails to comply with any of these covenants or otherwise defaults under a facility, the lender has the right to terminate the facility and require immediate repayment that may require sale of the collateral at less than optimal terms. In addition, if the Company defaults under one facility, it would generally trigger a default under the Company s other facilities.

The Company anticipates that its borrowings will be repaid from net proceeds from the sale of loans and other assets, cash flows from operations, or from refinancing the borrowings. The Company believes that it can continue to comply with loan covenants and that other alternative sources of credit are available to the Company to repay maturing loans if anticipated asset sales are not completed by loan due dates.

8. SECURITIZATION BOND FINANCING

The following is a summary of the outstanding securitization bond financing (dollars in thousands):

	December 31, 2003	September 30, 2004
Total secured bonds	$ 1,724,475	$ 3,277,732
Unamortized bond discount	(86)	(1,845)
Total Securitization bond financing, net	$ 1,724,389	$ 3,275,887

The bonds are collateralized by securitized loans with an aggregate outstanding principal balance of $1.8 billion and $3.4 billion as of December 31, 2003 and September 30, 2004, respectively. Unamortized debt issuance costs, included in other assets, are approximately $7.7 million and $12.1 million at December 31, 2003 and September 30, 2004, respectively.

Amounts collected by the Company as servicer of the mortgage loans are remitted to the trustee, who in turn distributes such amounts each month to the bondholders, together with other amounts received with respect to the mortgage loans, net of fees payable to the Company, trustee and insurer of the bonds. Interest collected each month on the mortgage loans will generally exceed the amount of interest accrued on the bonds. A portion of such excess interest will initially be distributed as principal to the bonds. As a result of such principal distributions, the excess of the unpaid principal balance of the loans over the unpaid principal balance of the bonds (overcollateralization) will increase. The securitization agreements require that a certain level of overcollateralization be maintained. Once a required level has been reached, excess interest will no longer be used to accelerate the amortization of the bonds. Whenever the level of overcollateralization falls below the required level, excess interest will again be paid as principal to the bonds until the required level has been reached. Excess interest that is not paid to the bonds in order to create or maintain the required overcollateralization level, or used to make certain other payments, will be passed through to the Company.

The securitization agreements provide that if delinquencies or losses on the underlying mortgage loans exceed certain maximums, the required levels of credit enhancement would be increased. During the nine months ended September 30, 2004, the Company received $56.5 million of excess interest from these securitizations. Therefore, the bonds are not necessarily expected to be outstanding through the stated maturity date set forth above.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the expected repayment requirements relating to the securitization bond financing at September 30, 2004. Amounts listed as bond payments are based on anticipated receipts of principal and interest on underlying mortgage loan collateral using historical prepayment speeds:

	September 30, 2004 (dollars in thousands)
Three months ending December 31:	
2004	$ 177,753
Years ending December 31:	
2005	1,075,453
2006	853,576
2007	459,372
2008	249,327
2009	183,544
Thereafter	278,707
Discount	(1,845)
Total	$ 3,275,887

9. INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The tax effects of significant items comprising the Company s net deferred tax asset were as follows (dollars in thousands):

	December 31, 2003	September 30, 2004
Loan securitizations*	$ 4,403	$ 14,699
Loans held for sale	11,408	10,700
Market reserve on loans held for sale	5,627	6,042
State taxes	3,419	2,504
Other reserves and accruals	1,712	2,768

Deferred tax assets	26,569	36,713
Mortgage-related securities	(10,517)	(11,104)
Investment in real estate investment trust		(8,395)
Deferred tax liabilities	(10,517)	(19,499)
Net deferred tax asset	$ 16,052	$ 17,214

* Includes the allowance for loan losses on securitized loans, net deferred origination fees on securitized loans, net basis adjustment for fair value hedging and miscellaneous temporary differences related to the off balance sheet securitization.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of the income tax (benefit) expense consisted of the following (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Federal:				
Current	$ 2,069	$ (1,352)	$ 39,920	$ 50,432
Deferred	13,788	20,345	(2,215)	(742)
	15,857	18,993	37,705	49,690
State:				
Current	494	(1,748)	9,517	11,154
Deferred	3,283	5,989	(528)	257
	3,777	4,241	8,989	11,411
Total	$ 19,634	$ 23,234	$ 46,694	$ 61,101

The deferred income tax expense resulted from temporary differences in the recognition of revenues and expenses for tax and financial statement purposes. The primary sources of these differences were the origination and reversal of various reserves, accruals and book/tax differences in the accounting for loans held for sale and mortgage securitizations.

The following is a reconciliation of the provision computed using the statutory federal income tax rate to the income tax provision reflected in the statements of operations (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2004	2003	2004
Federal income tax at statutory rate	$ 17,180	$ 21,095	$ 40,857	$ 54,228
State income tax, net of federal effects	2,457	2,756	5,843	7,417
Other	(3)	(617)	(6)	(544)

Total	$ 19,634	$ 23,234	$ 46,694	$ 61,101

During the nine months ended September 30, 2004, the Company recorded a $5.6 million reduction in income taxes payable and a corresponding increase to additional paid in capital related to corporate tax deductions arising from the sale by employees of common stock they acquired from the stock option plans and the ESPP prior to the fulfillment of required tax holding periods for such stock.

10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities were as follows (dollars in thousands):

	December 31, 2003	September 30, 2004
Accrued liabilities payroll	$ 16,884	$ 20,071
Accrued liabilities general	12,106	18,245
Reserve for repurchases	5,445	5,765
Futures contracts	9,359	3,874
Reserve for premium recapture	2,470	2,735
Accounts payable trade	385	285
Capital leases	12	
Total	$ 46,661	$ 50,975

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. MINORITY INTEREST

On August 12, 2004, Accredited Home Lenders Holding Co. s indirect subsidiary, Accredited Mortgage Loan REIT Trust, closed the public offering of 3,400,000 shares of Accredited Mortgage Loan REIT Trust s 9.75% Series A Perpetual Cumulative Preferred Shares. The offering resulted in gross proceeds of $85.0 million. These preferred shares have a par value of $1.00 and will pay investors cumulative dividends of $2.4375 per share annually, which is the equivalent of 9.75% of the $25.00 liquidation preference and face value per share.

On September 14, 2004, the underwriters of the above mentioned public offering purchased an additional 100,000 shares of the 9.75% Series A Perpetual Cumulative Preferred Shares pursuant to the exercise of their over-allotment option, resulting in gross proceeds of $2.5 million. See Note 16, Subsequent Event.

AHLHC has irrevocably and unconditionally agreed to pay in full to the holders of each share of REIT s Series A Preferred Shares, as and when due, regardless of any defense, right of set-off or counterclaim which REIT or AHLHC may have or assert: (i) all accrued and unpaid dividends (whether or not declared) payable on REIT s Series A Preferred Shares, (ii) the redemption price (including all accrued and unpaid dividends) payable with respect to any of REIT s Series A Preferred Shares redeemed by REIT and (iii) the liquidation preference, if any, payable with respect to any of REIT s Series A Preferred Shares. AHLHC s guarantee will be subordinated in right of payment to AHLHC s indebtedness, on a parity with the most senior class of AHLHC s preferred stock and senior to AHLHC s common stock. The Preferred Shares are classified as minority interest in subsidiary on the Company s consolidated balance sheet.

On September 9, 2004, the Company declared a quarterly cash dividend on the preferred shares at the rate of $0.3317 per share. The $1.2 million cash dividend was paid on September 30, 2004 to preferred stockholders on record at the close of business on September 15, 2004. The dividend payment is reported as minority interest dividends on preferred stock of subsidiary in the Company s statement of operations.

12. STOCKHOLDERS EQUITY

A summary of the changes in options outstanding under the Company s Stock Option Plans for the nine months ended September 30, 2004 follows:

	Number of Options	Weighted Average Exercise Price
Balance, January 1, 2004	1,699,619	$ 5.80
Options granted	423,475	35.54

Options exercised	(469,239)	2.40
Options cancelled	(207,965)	21.51
Balance, September 30, 2004	1,445,890	$ 13.35

2002 Employee Stock Purchase Plan The Company s 2002 Employee Stock Purchase Plan (the 2002 ESPP) was adopted effective as of the closing of the Offering by the board of directors and approved by the stockholders in 2002. A total of 1,500,000 shares of common stock are currently authorized and reserved for issuance under the plan, which provides that the plan be cumulatively increased each January 1 through January 1, 2013 according to the formula specified by the 2002 ESPP. Employees, including officers and employee directors, are eligible to participate in the 2002 ESPP if they are employed for more than 20 hours per week and more than five months in any calendar year. The 2002 ESPP permits participants to purchase common stock through payroll deductions of up to 15% of the participant s compensation. Such amounts are applied to the

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

purchase of shares of the Company s common stock at a price of 85% of the fair market value of the common stock as defined in the 2002 ESPP. On June 30, 2004, the Company issued 87,876 shares to employees with proceeds of $2.1 million. As of September 30, 2004, employees have contributed $1.3 million to the 2002 ESPP for future purchases of stock.

Deferred Compensation Plan The Company s Deferred Compensation Plan (the Plan) was adopted by the board of directors and approved by the stockholders in 2002. The Plan was effective as of January 1, 2003. A total of 2,000,000 shares of the Company s common stock is authorized and reserved for issuance under the Plan. The Plan is an unfunded, nonqualified deferred compensation plan that benefits directors, certain designated key members of management and highly compensated employees. Under the Plan, an employee may defer up to 100% of his or her base salary, director fee, bonus and/or commissions on a pre-tax basis. The Company may make both voluntary and/or matching contributions to the Plan on behalf of Plan participants and may make voluntary and/or matching contributions in the form of common stock. All Plan assets are corporate assets rather than individual property and are therefore subject to creditors claims against the Company. As of September 30, 2004, employees had voluntarily contributed $1.3 million to the Plan. In January 2004, April 2004 and July 2004, the Company awarded 158,538, 48,756 and 51,625 shares net of forfeitures, respectively, of restricted common stock under the Plan that vest 50% two years from the date of grant and 25% each year thereafter until fully vested. In March 2004, the Company granted 9,876 shares of restricted common stock under the Plan to its independent, outside directors and an additional 1,498 shares of restricted common stock to a member of its advisory board of directors, which vest in full two years from the date of grant.

13. EARNINGS PER SHARE (IN THOUSANDS, EXCEPT PER SHARE INFORMATION):

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted to common stock or resulted in the issuance of common stock that would then share in the earnings of the entity.

	Three Months Ended September 30, 2003		
	Net Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS	$ 29,449	19,651	$ 1.50
Effect of dilutive shares			
Stock options		1,355	
Unvested restricted stock		40	
Diluted EPS	$ 29,449	21,046	$ 1.40

	Three Months Ended September 30, 2004		
	Net Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS	$ 35,877	20,470	$ 1.75
Effect of dilutive shares			
Stock options		963	
Unvested restricted stock		147	
Diluted EPS	$ 35,877	21,580	$ 1.66

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Nine Months Ended September 30, 2003		
	Net Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS	$ 70,041	17,139	$ 4.09
Plus effect of income of assumed conversions			
Interest on convertible debt, net of tax	16		
Effect of dilutive shares			
Warrants *		67	
Stock options		1,306	
Unvested restricted stock		9	
Convertible preferred stock *		827	
Convertible debt *		339	
Diluted EPS	$ 70,057	19,687	$ 3.56

* Represents the dilutive effect of the shares outstanding prior to the initial public offering at February 14, 2003.

	Nine Months Ended September 30, 2004		
	Net Income (numerator)	Shares (denominator)	Per Share Amount
Basic EPS	$ 92,677	20,287	$ 4.57
Effect of dilutive shares			
Stock options		1,071	
Unvested restricted stock		158	
Diluted EPS	$ 92,677	21,516	$ 4.31

14. COMMITMENTS AND CONTINGENCIES

Leases The Company leases office space for its headquarters in San Diego, California, for various branch offices, executive suites, and record storage facilities across the country, and for certain equipment under operating leases expiring at various dates through 2013.

At September 30, 2004, the minimum future lease payments under non-cancelable operating leases were as follows (dollars in thousands):

Three Months Ending:	
2004	$ 2,402
Years ending:	
2005	9,583
2006	7,253
2007	5,660
2008	4,446
2009	2,425
Thereafter	1,742
Total	$ 33,511

ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its borrowers. These financial instruments primarily represent commitments to fund loans. These instruments involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the statement of financial position. The credit risk is mitigated by the Company s evaluation of the creditworthiness of potential mortgage loan borrowers on a case-by-case basis. The Company does not guarantee interest rates to potential borrowers when an application is received. Interest rates conditionally approved following the initial underwriting of applications are subject to adjustment if any conditions are not satisfied. The Company commits to originate loans, in many cases dependent on the borrower s satisfying various terms and conditions. These commitments totaled $177.3 million and $404.1 million as of December 31, 2003 and September 30, 2004, respectively.

Commitments to sell loans generally have fixed expiration dates or other termination clauses and may require payment of a commitment or a non-delivery fee. The Company periodically enters into other loan sale commitments. Loan sale commitments totaled $447.2 million and $1.0 billion at December 31, 2003 and September 30, 2004, respectively.

In connection with various regulatory lending requirements, the Company is required to maintain certain minimum levels of net worth. The Company was in compliance with these requirements at September 30, 2004.

From time to time, the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third party claims and other obligations customarily indemnified in the ordinary course of the Company s business. The terms of such obligations vary and, generally, a maximum obligation is not explicitly stated. Therefore, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations and no liabilities have been recorded for these obligations on its balance sheet as of September 30, 2004.

Legal Because the nature of the Company s business involves the collection of numerous accounts, the validity of liens and compliance with various state and federal lending laws, it is subject to various legal proceedings in the ordinary course of business related to foreclosures, bankruptcies, condemnation and quiet title actions, and alleged statutory and regulatory violations. The Company is also subject to legal proceedings in the ordinary course of business related to employee matters. Except as specifically set forth below, the Company does not believe that the resolution of these lawsuits in the ordinary course of business will have a material adverse effect on its financial position or results of operations.

In December 2002, the Company was served with a complaint and motion for class certification in a class action lawsuit, *Wratchford et al. v. Accredited Home Lenders, Inc*., brought in Madison County, Illinois under the Illinois Consumer Fraud and Deceptive Business Practices Act and the consumer protection statutes of the other states in which the Company does business. The complaint alleges that the Company has a practice of misrepresenting and inflating the amount of fees Accredited pays to third parties in connection with the residential mortgage loans the Company funds. Plaintiffs claim to represent a nationwide class consisting of all other persons similarly situated, that is, all persons who paid money to the Company to pay, or reimburse the Company s payments of, third-party fees in connection with residential mortgage loans and never received a refund for the difference between what they paid and what was actually paid to the third party. Plaintiffs are seeking to recover damages on behalf of themselves and the class, in addition to pre-judgment interest, post-judgment interest, and any other relief the court deems just and proper. The Company filed an answer to the complaint on January 17, 2003, and a hearing on the motion for class certification has been scheduled for December 21, 2004, but there has not yet been a ruling on the merits of either plaintiffs individual claims of the class. At the present time, the ultimate outcome of this matter and the amount of liability, if any, that may result

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

is not determinable, and no amounts have been accrued in the Company s financial statements with respect to this matter. The Company intends to vigorously defend this matter and does not believe it will have a material adverse effect on the Company s business.

In January 2004, the Company was served with a complaint, *Yturralde v. Accredited Home Lenders, Inc.,* brought in Sacramento County, California. The complaint alleges that the Company violated California and federal law by misclassifying the plaintiff, formerly a commissioned loan officer for the Company, as an exempt employee and failing to pay the plaintiff on an hourly basis and for overtime worked. The plaintiff seeks to recover, on behalf of himself and all of the Company s other similarly situated current and former employees, lost wages and benefits, general damages, multiple statutory penalties and interest, attorneys fees and costs of suit, and also seeks to enjoin further violations of wage and overtime laws and retaliation against employees who complain about such violations. The Company has been served with eleven substantially similar complaints on behalf of other former and current employees of the Company, which eleven actions have been consolidated with the *Yturralde* action. In addition, under current California law, a private individual who is not a current or former employee of an employer may bring an action to enforce certain provisions of California law against that employer. Such a complaint regarding this matter has been filed and served upon the Company. In September 2004, the Company appealed the court s denial of the Company s motion to compel arbitration of the consolidated cases, and a resolution of that appeal is not expected before early 2006. In the meantime, discussions have resumed between the parties regarding potential mediation of the claims. The Company does not believe these matters will have a material adverse effect on its business, but, at the present time, the ultimate outcome of the litigation and the total amount of liability is not determinable. As a result, the Company has not accrued any amounts in its financial statements with respect to the litigation. However, the Company is pursuing settlements directly with current and former employees covered by the allegations of the complaints and, to date, the Company has effected settlements with many of these current and former employees. Accordingly, the Company has accrued amounts that are estimable in its financial statements for this group of current and former employees.

In June 2004, the Company was served with a class action complaint, *Aslam v. Accredited Home Lenders, Inc., et al.,* brought in Cook County, Illinois. The complaint alleges that the purchase money, first priority mortgage loan the Company made to the plaintiff violated Illinois law because the loan, which had an interest rate in excess of 8%, included a prepayment charge and because the Company charged certain fees for the loan, which fees allegedly exceeded 3% of the original loan amount. The plaintiff seeks to recover, on behalf of himself and all other individuals to which the Company made loans with the same alleged violations, the damages allowed by statute, interest, costs and attorneys fees. The damages allowed by statute include actual economic damage and an amount equal to twice the total of all interest, discount and charges determined by the loan contract or paid by the obligor, whichever is greater. To the extent the plaintiff s loan included any provisions or fees which might otherwise violate Illinois law, the Company included those provisions or fees in plaintiff s loan on the basis that federal law preempted Illinois law with respect to plaintiff s loan. The Company s position in this regard was consistent with prior case law and previously announced positions of the Illinois Attorney General and the Illinois Office of Banks and Real Estate. However, in a decision filed on March 31, 2004, in *U.S. Bank, National Association, et al., v. Clark, et al*., consolidated cases that involve alleged violations of Illinois law similar to those alleged against the Company, an Illinois appellate court held that federal preemption was not available for the non-purchase money, first priority mortgage loans involved in those cases. A petition for leave to appeal to the Supreme Court of Illinois has been filed in the *Clark* litigation, but, if the Clark decision is not reversed on appeal, the rationale by which the Clark court reached its decision may undermine the Company s ability to rely on federal preemption with respect to the loans it made to the plaintiff and other Illinois residents. The Company does not believe the loan it made to the plaintiff violates Illinois law even if not preempted by federal law, and, in November 2004, the *Aslam* suit was settled for a nominal sum. This settlement was with the individual plaintiff, not on behalf of any class, and the potential liability to the Company

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

represented by the Clark decision still exists. If one or more other Illinois residents were to successfully pursue a class action against the Company based on the Clark decision, the potential liability could materially and adversely affect the Company. At the present time, the likelihood of such a suit being brought, the ultimate outcome of any such suit and the amount of liability, if any, that might result is not determinable, and the Company has not accrued any amounts in its financial statements with respect to this potential liability.

15. SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL INFORMATION

During the second quarter of 2004, Accredited Mortgage Loan REIT Trust (REIT) was formed as a Maryland real estate investment trust for the purpose of acquiring, holding and managing real estate assets. All of the outstanding common shares of beneficial interest of REIT are held by AHL, a wholly owned subsidiary of AHLHC. AHLHC is the guarantor of REIT s payment obligations in connection with the issuance of the REIT s Series A Cumulative Preferred Shares in August, September and October 2004 (see Note 11 and 16). Such guarantee is full, unconditional and joint and several. The following supplemental financial information sets forth, on an unconsolidated basis, balance sheet, statement of income, and statement of cash flow information for AHLHC and its subsidiaries. The supplemental financial information reflects the investments of AHLHC in the subsidiaries using the equity method of accounting. The supplemental financial information is presented as of December 31, 2003 and September 30, 2004, and for the three and nine months ended September 30, 2003 and September 30, 2004.

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING BALANCE SHEET

AS OF DECEMBER 31, 2003

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Eliminations	Consolidated
ASSETS				
Cash and cash equivalents	$ 741	$ 26,378	$	$ 27,119
Restricted cash	87	122		209
Mortgage loans held for sale, net of market reserve of $12,213		1,277,075		1,277,075
Mortgage loans held for investment, net of allowance for loan losses of $19,890		2,090,237		2,090,237
Mortgage-related securities, at fair value		3,692		3,692
Mortgage servicing rights, net		1,119		1,119
Furniture, fixtures and equipment, net		20,674		20,674
Accounts receivable intercompany	44,968	(44,968)		
Other receivables	2	44,909		44,911
Investment in subsidiary	166,425		(166,425)	
Deferred income tax asset		16,052		16,052
Prepaid expenses and other assets		20,329		20,329
TOTAL	$ 212,223	$ 3,455,619	$ (166,425)	$ 3,501,417
LIABILITIES AND STOCKHOLDERS EQUITY				
LIABILITIES:				
Warehouse facilities	$	$ 1,515,195	$	$ 1,515,195
Securitization bond financing		1,724,389		1,724,389
Income taxes payable		2,949		2,949
Accounts payable and accrued liabilities		46,661		46,661
Total liabilities		3,289,194		3,289,194
STOCKHOLDERS EQUITY:				
Common stock	20			20
Additional paid-in capital	59,609	10,910	(9,726)	61,585
Note receivable for common stock		(1,250)		(1,250)
Unearned compensation	(4,897)	(726)		(5,623)
Retained earnings	157,491	157,491	(156,699)	157,491
Total stockholders equity	212,223	166,425	(166,425)	212,223

TOTAL	$ 212,223	$ 3,455,619	$ (166,425)	$ 3,501,417

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING BALANCE SHEET

AS OF SEPTEMBER 30, 2004

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Accredited Mortgage Loan REIT Trust	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	$ 1,007	$ 17,542	$ 54,920	$	$ 73,469
Restricted cash	1,305	4,385			5,690
Mortgage loans held for sale, net of market reserve of $14,372		1,848,376			1,848,376
Mortgage loans held for investment, net of allowance for loan losses of $51,328		1,527,533	2,519,513		4,047,046
Mortgage-related securities, at fair value		3,754			3,754
Mortgage servicing rights, net		331			331
Furniture, fixtures and equipment, net	12	32,641			32,653
Accounts receivable intercompany	54,502	(50,155)	(4,347)		
Other receivables	8	38,086	22,476		60,570
Investment in subsidiary	257,474	74,464		(331,938)	
Prepaid income taxes		19,878			19,878
Deferred income tax asset		17,214			17,214
Prepaid expenses and other assets	3	17,769	9,921		27,693
TOTAL	$ 314,311	$ 3,551,818	$ 2,602,483	$ (331,938)	$ 6,136,674
LIABILITIES AND STOCKHOLDERS EQUITY					
LIABILITIES:					
Warehouse facilities	$	$ 2,411,415	$	$	$ 2,411,415
Securitization bond financing		837,201	2,438,686		3,275,887
Income taxes payable					
Accounts payable and accrued liabilities	8	45,728	5,239		50,975
Total liabilities	8	3,294,344	2,443,925		5,738,277
Minority interest in subsidiary				84,094	84,094
STOCKHOLDERS EQUITY:					
Preferred stock			3,500	(3,500)	
Additional paid-in capital-preferred stock			80,594	(80,594)	
Common stock	21				21

Additional paid-in capital-common stock	75,219	11,038	56,584	(63,871)	78,970
Note receivable for common stock		(1,250)			(1,250)
Unearned compensation	(11,105)	(580)			(11,685)
Accumulated other comprehensive loss		(871)	(1,050)		(1,921)
Retained earnings	250,168	249,137	18,930	(268,067)	250,168
Total stockholders equity	314,303	257,474	158,558	(416,032)	314,303
TOTAL	$ 314,311	$ 3,551,818	$ 2,602,483	$ (331,938)	$ 6,136,674

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2003

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Eliminations	Consolidated
REVENUES:				
Interest income	$	$ 47,870	$	$ 47,870
Gain on sale of loans		65,237		65,237
Loan servicing income		1,979		1,979
Net gain on mortgage-related securities and derivatives		1,051		1,051
Other income		98		98
Equity in net earnings of subsidiary	29,449		(29,449)	
Total revenues	29,449	116,235	(29,449)	116,235
EXPENSES:				
Salaries, wages and benefits		28,700		28,700
Interest expense		16,616		16,616
Occupancy		3,449		3,449
Provision for losses		6,537		6,537
Depreciation and amortization		1,260		1,260
General and administrative expenses		10,590		10,590
Total expenses		67,152		67,152
INCOME BEFORE INCOME TAXES	29,449	49,083	(29,449)	49,083
INCOME TAXES		19,634		19,634
NET INCOME	$ 29,449	$ 29,449	$ (29,449)	$ 29,449

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Accredited Mortgage Loan REIT Trust	Eliminations	Consolidated
REVENUES:					
Interest income	$	$ 64,594	$ 32,919	$ (20)	$ 97,493
Gain on sale of loans		77,993			77,993
Loan servicing income		1,996			1,996
Net gain on mortgage-related securities and derivatives		309			309
Other income		2,483	116	(2,316)	283
Equity in net earnings of subsidiary	37,153	17,549		(54,702)	
Total revenues	37,153	164,924	33,035	(57,038)	178,074
EXPENSES:					
Salaries, wages and benefits	75	42,599			42,674
Interest expense		26,402	10,732	(20)	37,114
Occupancy	15	4,795			4,810
Provision for losses		11,983	2,433		14,416
Depreciation and amortization		2,911			2,911
General and administrative expenses	26	15,847	2,321	(2,316)	15,878
Total expenses	116	104,537	15,486	(2,336)	117,803
INCOME BEFORE INCOME TAXES	37,037	60,387	17,549	(54,702)	60,271
INCOME TAXES		23,234			23,234
MINORITY INTEREST DIVIDENDS ON PREFERRED STOCK OF SUBSIDIARY				1,160	1,160
NET INCOME	$ 37,037	$ 37,153	$ 17,549	$ (55,862)	$ 35,877

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING STATEMENTS OF OPERATIONS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Eliminations	Consolidated
REVENUES:				
Interest income	$	$ 120,484	$	$ 120,484
Gain on sale of loans		171,317		171,317
Loan servicing income		5,789		5,789
Net gain on mortgage-related securities and derivatives		5,439		5,439
Other income		583		583
Equity in net earnings of subsidiary	70,041		(70,041)	
Total revenues	70,041	303,612	(70,041)	303,612
EXPENSES:				
Salaries, wages and benefits		79,523		79,523
Interest expense		43,628		43,628
Occupancy		8,448		8,448
Provision for losses		22,916		22,916
Depreciation and amortization		3,343		3,343
General and administrative expenses		29,019		29,019
Total expenses		186,877		186,877
INCOME BEFORE INCOME TAXES	70,041	116,735	(70,041)	116,735
INCOME TAXES		46,694		46,694
NET INCOME	$ 70,041	$ 70,041	$ (70,041)	$ 70,041

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ACCREDITED HOME LENDERS HOLDING CO. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUPPLEMENTAL CONSOLIDATING STATEMENTS OF OPERATIONS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004

(dollars in thousands)	Accredited Home Lenders Holding Co.	Accredited Home Lenders, Inc.	Accredited Mortgage Loan REIT Trust	Eliminations	Consolidated
REVENUES:					