

AMERICAN HOME MORTGAGE INVESTMENT CORP

Form 10-Q

May 10, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended March 31, 2007.

OR

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

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

Commission File Number: 001-31916

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**AMERICAN HOME MORTGAGE INVESTMENT CORP.**

(Exact Name of Registrant as Specified in its Charter)

Maryland  
(State or Other Jurisdiction of

Incorporation or Organization)

20-0103914  
(I.R.S. Employer

Identification No.)

538 Broadhollow Road, Melville, New York  
(Address of Principal Executive Offices)

(516) 949-3900

11747  
(Zip Code)

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(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-Accelerated Filer ☐

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

As of May 4, 2007, there were 54,278,645 shares of the registrant's common stock, par value \$0.01 per share, outstanding.

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**AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES**

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**Table of Contents****AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands, except per share amounts)

	March 31, 2007 (Unaudited)	December 31, 2006
<b>Assets:</b>		
Cash and cash equivalents	\$ 836,860	\$ 398,166
Securities purchased under agreements to resell	58,675	
Accounts receivable and servicing advances	316,673	432,418
Securities (including securities pledged of \$6,547,901 as of March 31, 2007 and \$8,690,803 as of December 31, 2006)	7,557,886	9,308,032
Mortgage loans held for sale, net	955,451	1,523,737
Mortgage loans held for sale, at fair value	3,926,296	
Mortgage loans held for investment, net of allowance of \$16,586 as of March 31, 2007 and \$14,191 as of December 31, 2006	6,010,969	6,329,721
Derivative assets	22,718	32,142
Mortgage servicing rights	525,565	506,341
Premises and equipment, net	87,723	86,211
Goodwill	133,248	133,128
Other assets	121,871	79,089
Total assets	\$ 20,553,935	\$ 18,828,985
<b>Liabilities and Stockholders Equity:</b>		
<b>Liabilities:</b>		
Warehouse lines of credit	\$ 4,013,190	\$ 1,304,541
Commercial paper	1,696,256	1,273,965
Reverse repurchase agreements	6,727,505	8,571,459
Deposits	184,614	24,016
Collateralized debt obligations	4,719,376	4,854,801
Payable for securities purchased	595,277	289,716
Derivative liabilities	36,550	12,644
Trust preferred securities	336,616	336,078
Accrued expenses and other liabilities	396,109	361,923
Notes payable	531,867	417,467
Income taxes payable	92,831	112,089
Total liabilities	19,330,191	17,558,699
<b>Commitments and contingencies</b>		
<b>Stockholders Equity:</b>		
Preferred Stock, par value \$0.01 per share, 10,000,000 shares authorized:		
9.75% Series A Cumulative Redeemable, 2,150,000 shares issued and outstanding as of March 31, 2007 and December 31, 2006	50,857	50,857
9.25% Series B Cumulative Redeemable, 3,450,000 shares issued and outstanding as of March 31, 2007 and December 31, 2006	83,183	83,183
Common Stock, par value \$0.01 per share, 100,000,000 shares authorized, 50,273,878 and 50,195,499 shares issued and outstanding as of March 31, 2007 and December 31, 2006, respectively	503	502
Additional paid-in capital	965,034	963,617

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Retained earnings	173,900	257,283
Accumulated other comprehensive loss	(49,733)	(85,156)
Total stockholders' equity	1,223,744	1,270,286
Total liabilities and stockholders' equity	\$ 20,553,935	\$ 18,828,985

See notes to consolidated financial statements (unaudited).

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**Table of Contents****AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

(In thousands, except per share amounts)

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Net interest income:		
Interest income	\$ 394,277	\$ 300,613
Interest expense	(333,738)	(254,035)
Total net interest income	60,539	46,578
Provision for loan losses	(9,143)	(1,311)
Total net interest income after provision for loan losses	51,396	45,267
Non-interest income:		
Gain on sales of mortgage loans	126,817	171,907
(Loss) gain on securities and derivatives	(4,242)	8,465
Loan servicing fees	46,084	24,333
Changes in fair value of mortgage servicing rights:		
Due to realization of cash flows	(24,959)	(18,735)
Due to changes in valuation assumptions, net of hedge gain	(1,076)	114
Net loan servicing fees	20,049	5,712
Other non-interest income	3,221	1,769
Total non-interest income	145,845	187,853
Non-interest expenses:		
Salaries, commissions and benefits, net	107,871	99,267
Occupancy and equipment	21,306	17,970
Data processing and communications	5,377	7,126
Office supplies and expenses	4,851	4,332
Marketing and promotion	4,278	5,800
Travel and entertainment	7,797	6,753
Professional fees	6,904	5,331
Other	20,850	15,882
Total non-interest expenses	179,234	162,461
Net income before income tax (benefit) expense	18,007	70,659
Income tax (benefit) expense	(12,675)	16,200
Net income	\$ 30,682	\$ 54,459
Dividends on preferred stock	3,305	3,305

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Net income available to common stockholders	\$	27,377	\$	51,154
Per share data:				
Basic	\$	0.55	\$	1.03
Diluted	\$	0.54	\$	1.02
Weighted average number of shares basic		50,223		49,715
Weighted average number of shares diluted		50,499		50,070
See notes to consolidated financial statements (unaudited).				

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**Table of Contents****AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (Unaudited)****THREE MONTHS ENDED MARCH 31, 2007 AND 2006**

<b>(Dollars in thousands)</b>	<b>Preferred Stock</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Loss</b>	<b>Total Stockholders Equity</b>
Balance at January 1, 2006	\$ 134,040	\$ 496	\$ 947,512	\$ 203,778	\$ (78,810)	\$ 1,207,016
Comprehensive income:						
Net income				54,459		54,459
Net change in accumulated other comprehensive loss					13,990	13,990
Comprehensive income						68,449
Cumulative effect adjustment due to adoption of SFAS No. 156				(2,917)		(2,917)
Issuance of Common Stock - earnouts		3	9,555			9,558
Issuance of Common Stock - 1999 Omnibus Stock Incentive Plan		1	698			699
Stock-based employee compensation expense			410			410
Dividends declared on Series A Preferred Stock				(1,310)		(1,310)
Dividends declared on Series B Preferred Stock				(1,995)		(1,995)
Dividends declared on Common Stock				(45,503)		(45,503)
Balance at March 31, 2006	\$ 134,040	\$ 500	\$ 958,175	\$ 206,512	\$ (64,820)	\$ 1,234,407
Balance at January 1, 2007	\$ 134,040	\$ 502	\$ 963,617	\$ 257,283	\$ (85,156)	\$ 1,270,286
Comprehensive income:						
Net income				30,682		30,682
Net change in accumulated other comprehensive loss					(19,030)	(19,030)
Comprehensive income						11,652
Cumulative effect adjustment due to adoption of SFAS No. 159				(54,453)	54,453	
Issuance of Common Stock - 1999 Omnibus Stock Incentive Plan		1	798			799
Stock-based employee compensation expense			322			322
Tax benefit from stock options exercised			297			297
Dividends declared on Series A Preferred Stock				(1,310)		(1,310)
Dividends declared on Series B Preferred Stock				(1,995)		(1,995)
Dividends declared on Common Stock				(56,307)		(56,307)
Balance at March 31, 2007	\$ 134,040	\$ 503	\$ 965,034	\$ 173,900	\$ (49,733)	\$ 1,223,744

See notes to consolidated financial statements (unaudited).



**Table of Contents****AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

(In thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net income	\$ 30,682	\$ 54,459
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	5,637	3,953
Provision for loans held for investment	9,143	1,311
Provision (recovery) for loans held for sale	60,543	(412)
Change in fair value of mortgage servicing rights	26,421	18,621
Accretion and amortization of mortgage-backed securities, net	(8,530)	2,331
Deferred cash flow hedge gain, net of amortization	8,323	3,909
Gain on sales of mortgage-backed securities and derivatives	(5,155)	
Unrealized loss on mortgage-backed securities	14,073	3,090
Unrealized loss (gain) on free standing derivatives	3,431	(4,765)
Increase (decrease) in forward delivery contracts	13,174	(24,041)
Capitalized mortgage servicing rights on sold loans	(45,645)	(69,768)
(Increase) decrease in interest rate lock commitments	(8,904)	7,131
Fair value in excess of cost basis on mortgage loans held for sale, fair value	(44,831)	
Cost basis adjustments on mortgage loans held for sale, fair value	(52,100)	
Decrease in mortgage loan basis adjustments	9,836	4,731
Excess tax benefits from share-based payment arrangements	(297)	
Other	3,111	(198)
(Increase) decrease in operating assets:		
Accounts receivable	118,178	6,829
Servicing advances	(2,433)	(3,281)
Other assets	11,210	(1,451)
Increase (decrease) in operating liabilities:		
Accrued expenses and other liabilities	22,412	93,876
Income taxes payable	(18,961)	16,173
Origination of mortgage loans held for sale	(16,624,997)	(12,203,014)
Principal received from sales of mortgage loans held for sale	13,255,213	13,372,986
Additions to mortgage-backed securities and derivatives	(67,834)	
Principal proceeds from sales of self-originated mortgage-backed securities		1,809,796
Cash received from residual assets in securitizations	16,519	27,353
Principal repayments of mortgage-backed securities	39,340	93,845
Net cash (used in) provided by operating activities	(3,232,441)	3,213,464
Cash flows from investing activities:		
Purchases of premises and equipment	(7,149)	(10,765)
Origination of mortgage loans held for investment	(121,224)	(970,335)
Proceeds from repayments and dispositions of mortgage loans held for investment	425,385	137,545
Net increase in securities purchased under agreements to resell	(58,675)	
Purchases of mortgage-backed securities	(1,452,021)	(1,389,336)
Principal proceeds from sales of purchased mortgage-backed securities	2,737,023	
Principal repayments of purchased mortgage-backed securities	474,015	438,297

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Net increase in investment in Federal Home Loan Bank stock, at cost	(713)	
Acquisition of business		(550,077)
Net cash provided by (used in) investing activities	1,996,641	(2,344,671)
Cash flows from financing activities:		
Increase (decrease) in warehouse lines of credit, net	2,708,649	(1,719,610)
Decrease in reverse repurchase agreements, net	(1,843,954)	(907,094)
Increase in deposits	160,598	
(Decrease) increase in collateralized debt obligations	(135,425)	1,847,293
Increase (decrease) in payable for securities purchased	305,561	(46,425)
Increase (decrease) in commercial paper, net	422,291	(5,549)
Decrease in drafts payable, net	(2,751)	(4,377)
Increase in trust preferred securities	538	330
Increase in notes payable, net	114,400	11,405
Proceeds from issuance of Common Stock	802	652
Excess tax benefits from share-based payment arrangements	297	
Dividends paid	(56,512)	(48,477)
Net cash provided by (used in) financing activities	1,674,494	(871,852)
Net increase (decrease) in cash and cash equivalents	438,694	(3,059)
Cash and cash equivalents, beginning of period	398,166	575,650
Cash and cash equivalents, end of period	\$ 836,860	\$ 572,591
Supplemental disclosure of cash flow information:		
Interest paid	\$ 318,455	\$ 181,955
Income taxes paid	\$ 6,345	\$ 32
Supplemental disclosure of non-cash investing information:		
Net transfer of loans held for sale to loans held for investment	\$ 10,135	\$
See notes to consolidated financial statements (unaudited).		

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### **AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

#### **NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization** American Home Mortgage Investment Corp. ( AHM Investment ) is a mortgage REIT focused on earning net interest income from mortgage loans and securities, and, through its taxable subsidiaries, on earning income from originating and selling mortgage loans and servicing mortgage loans for institutional investors. Mortgages are originated through a network of loan origination offices and mortgage brokers or are purchased from correspondents, and are serviced at the Company's Irving, Texas servicing center. As used herein, references to the Company, American Home, we, our and us refer to AHM Investment collectively with its subsidiaries.

**Basis of Presentation** The preparation of 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 liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's estimates and assumptions primarily arise from risks and uncertainties associated with interest rate volatility, prepayment volatility, credit exposure and regulatory changes. Although management is not currently aware of any factors that would significantly change its estimates and assumptions in the near term, future changes in market trends and conditions may occur which could cause actual results to differ materially.

Due to the Company's exercising significant influence on the operations of its joint ventures, their balances and operations have been fully consolidated in the accompanying consolidated financial statements and all intercompany accounts and transactions have been eliminated.

**Cash and Cash Equivalents** Cash and cash equivalents are demand deposits and short-term investments with a maturity of 90 days or less. The carrying amount of cash and cash equivalents approximates its fair value.

**Fair Value** A substantial portion of the Company's assets and certain of the Company's liabilities are carried at fair value. At the beginning of 2007, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, *Fair Value Measurements* ( SFAS No. 157 ), and SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ). The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. With the adoption of SFAS No. 159, the Company recognized a gain of approximately \$44.8 million during the three months ended March 31, 2007, related to the fair value in excess of cost basis of mortgage loans held for sale. The Company's cost basis adjustments relating to the direct costs of originating the loans were \$52.1 million during the three months ended March 31, 2007, and were recognized in earnings. The transition adjustment to beginning retained earnings related to the adoption of SFAS No. 159 was a loss of \$54.5 million, net of tax, all of which related to applying the fair value option to securities.

**Securities, at Fair Value** The fair values of the Company's securities carried at fair value are generally based on market prices provided by certain dealers who make markets in these financial instruments. Changes in the fair value of securities are recognized in earnings and are included in (loss) gain on securities and derivatives.

**Mortgage Loans Held for Sale** Mortgage loans held for sale originated prior to January 1, 2007 are carried at the lower of cost or aggregate market value ( LOCOM ). The cost basis includes the capitalized value of the prior interest rate lock commitments ( IRLCs ) related to the mortgage loans and any net deferred origination costs. For mortgage loans held for sale that are hedged with forward sale commitments, if the Company meets hedge accounting requirements, the carrying value is adjusted for the change in market during the time the hedge was deemed to be highly effective. The market value is determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate basis.

**Mortgage Loans Held for Sale, at Fair Value** Mortgage loans held for sale originated after January 1, 2007 are carried at fair value. The fair value of mortgage loans held for sale may be determined by either outstanding commitments from investors, recent trade prices for identical or similar loans, or other observable data. Unrealized gain or loss is recognized in earnings for the difference between the cost basis, including upfront costs and fees, and the fair value of the loans. Unrealized gain or loss is included in gain on sales of mortgage loans.

**Mortgage Loans Held for Investment** Mortgage loans held for investment represent loans securitized through transactions structured as financings, or pending securitization through transactions that are expected to be structured as financings. Mortgage loans held for investment are carried at the aggregate of their remaining unpaid principal balances, including the capitalized value of the prior IRLCs related to the mortgage loans, plus net deferred origination costs, less any related charge-offs and allowance for loan losses. Loan fees and direct origination costs are deferred and amortized into interest income over the contractual life of the loan using the level-yield method.



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***Allowance for Losses on Mortgage Loans Held for Investment*** The Company maintains an allowance for loan losses for its mortgage loans held for investment, based on the Company's estimate of current existing losses. Additions to the allowance for loan losses are based on assessments of certain factors, including historical loan loss experience of similar types of loans, the Company's loan loss experience, the amount of past due and nonperforming loans, specific known risks, the value of collateral securing the loans, and current and anticipated economic and interest rate conditions. Evaluation of these factors involves subjective estimates and judgments that may change. Additions to the allowance for loan losses are provided through a charge to income and recorded within provision for loan losses in the consolidated statements of income. The allowance for loan losses is reduced by subsequent charge-offs, net of recoveries.

***Real Estate Owned*** The Company's real estate owned ( REO ) represents property acquired through foreclosure or other proceedings. REO is carried at the lower of cost or fair value, less costs to sell. REO is reported in other assets in the consolidated balance sheet. The Company periodically evaluates all REO, and reductions in carrying value are recognized in other non-interest expenses in the consolidated statements of income.

***Mortgage Servicing Rights*** In March 2006, the Financial Accounting Standards Board ( FASB ) released SFAS No. 156, *Accounting for Servicing Financial Assets, an amendment of SFAS No. 140* ( SFAS No. 156 ). SFAS No. 156 amends SFAS No. 140 to require that all separately recognized servicing assets and liabilities be initially measured at fair value, if practical. The effective date of this statement is as of the beginning of the entity's first fiscal year that begins after September 15, 2006; however, early adoption is permitted as of the beginning of any fiscal year, provided the entity has not issued financial statements for the interim period. The initial recognition and measurement of servicing assets and servicing liabilities are required to be applied prospectively to transactions occurring after the effective date. The Company elected to early adopt SFAS No. 156 as of January 1, 2006 and, upon measurement of its mortgage servicing rights ( MSRs ) at fair value, recorded a cumulative effect adjustment to retained earnings of \$718 thousand after tax. The Company's election increased MSRs by \$1.2 million. Prior to January 1, 2006, MSRs were carried at the lower of cost or fair value, based on defined interest rate risk strata, and the gross MSR asset was amortized in proportion to and over the period of estimated net servicing income. The Company estimates the fair value of its MSRs by obtaining market information from one of the market's primary independent MSR brokers.

***Premises and Equipment*** Premises and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is provided using the straight-line method over the estimated service lives of the premises and equipment. Leasehold improvements are amortized over the lesser of the life of the lease or service lives of the improvements using the straight-line method. Depreciation and amortization are recorded within occupancy and equipment expense in the consolidated statements of income.

***Goodwill*** Goodwill represents the excess purchase price over the fair value of net assets acquired from business acquisitions. The Company's goodwill includes earnouts, consisting of cash and shares of the Company's common stock, par value \$0.01 per share ( Common Stock ), paid to former shareholders of previously acquired companies. The Company tests for impairment at least annually and will test for impairment more frequently if events or circumstances indicate that an asset may be impaired. The Company tests for impairment by comparing the fair value of goodwill, as determined by using a discounted cash flow method, with its carrying value. Any excess of carrying value over the fair value of the goodwill would be recognized as an impairment loss in continuing operations. The discounted cash flow calculation related to the Company's loan origination segment includes a forecast of the expected future loan originations and the related revenues and expenses. The discounted cash flow calculation related to the Company's mortgage holdings segment includes a forecast of the expected future net interest income, gain on securities and derivatives and the related revenues and expenses. These cash flows are discounted using a rate that is estimated to be a weighted-average cost of capital for similar companies.

***Reverse Repurchase Agreements*** The Company has entered into reverse repurchase agreements to finance certain of its investments. These agreements are secured by a portion of the Company's investments and bear interest rates that have historically moved in close relationship to the London Inter-Bank Offer Rate ( LIBOR ). Reverse repurchase agreements are accounted for as borrowings and recorded as a liability on the consolidated balance sheet.

***Collateralized Debt Obligations*** The Company has issued adjustable-rate collateralized debt obligations ( CDOs ) to finance certain portions of its mortgage loans. The CDOs are collateralized by primarily adjustable-rate mortgage ( ARM ) loans that have been placed in a trust and bear interest rates that have historically moved in close relationship to LIBOR. CDOs are accounted for as borrowings and recorded as a liability on the consolidated balance sheet.

***Commercial Paper*** The Company maintains a wholly owned special purpose entity for the purpose of issuing commercial paper in the form of short-term Secured Liquidity Notes ( SLNs ) to finance certain portions of the Company's mortgage loans held for sale and mortgage loans held for investment. The commercial paper may be secured by the Company's mortgage loans held for sale, mortgage loans held for investment, mortgage-backed securities ( MBS ) or cash and bears interest at prevailing money market rates approximating LIBOR. Commercial paper is accounted for as a borrowing and recorded as a liability on the consolidated balance sheet.



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***Trust Preferred Securities*** The Company has formed wholly owned statutory business trusts ( *Trusts* ) for the purpose of issuing trust preferred securities. The Company does not consolidate its Trusts, which results in a liability to the Trusts, which is recorded in trust preferred securities on the consolidated balance sheet.

***Derivative Financial Instruments*** The Company has developed risk management programs and processes designed to manage market risk associated with normal business activities.

***Interest Rate Lock Commitments ( IRLCs )***. The Company's mortgage committed pipeline includes IRLCs that have been extended to borrowers who have applied for loan funding and meet certain defined credit and underwriting criteria and have locked their terms and rates. The Company uses mortgage forward delivery contracts to economically hedge the IRLCs. The Company classifies and accounts for the IRLCs associated with loans expected to be sold as free-standing derivatives. Accordingly, IRLCs related to loans held for sale are recorded at fair value with changes in fair value recorded to current earnings.

***Forward Delivery Commitments Used to Economically Hedge IRLCs***. The Company uses mortgage forward delivery contracts to economically hedge the IRLCs, which are also classified and accounted for as free-standing derivatives and thus are recorded at fair value with the changes in fair value recorded to current earnings.

***Forward Delivery Commitments Used to Hedge Mortgage Loans Held for Sale***. The Company's risk management objective for its mortgage loans held for sale is to protect earnings from an unexpected charge due to a decline in value. The Company's strategy is to engage in a risk management program involving the use of mortgage forward delivery contracts designated as fair value hedging instruments to hedge 100% of its agency-eligible conforming loans and most of its non-conforming loans held for sale. At the inception of the hedge, to qualify for hedge accounting, the Company formally documents the relationship between the forward delivery contracts and the mortgage inventory as well as its objective and strategy for undertaking the hedge transaction. For conventional conforming fixed-rate loans, the notional amount of the forward delivery contracts, along with the underlying rate and terms of the contracts, are equivalent to the unpaid principal amount of the mortgage inventory being hedged; hence, the forward delivery contracts effectively fix the forward sales price and thereby substantially eliminate interest rate and price risk to the Company. The Company classifies and accounts for these forward delivery contracts as fair value hedges. The derivatives are carried at fair value with the changes in fair value recorded to current earnings. When the hedges are deemed highly effective, the book value of the hedged loans held for sale is adjusted for its change in fair value during the hedge period.

***Total Return Swaps Used to Economically Hedge MSRs***. The Company uses agency trust principal only total return swaps to economically hedge its MSRs, which are also classified and accounted for as free-standing derivatives and thus are recorded at fair value with the changes in fair value recorded to current earnings.

***Swaptions Used to Economically Hedge MSRs***. The Company uses swaptions to economically hedge its MSRs, which are also classified and accounted for as free-standing derivatives and thus are recorded at fair value with the changes in fair value recorded to current earnings.

***Interest Rate Swap Agreements***. The Company enters into interest rate swap agreements which require it to pay a fixed interest rate and receive a variable interest rate based on LIBOR. The fair value of interest rate swap agreements is based on the net present value of estimated future interest payments over the remaining life of the interest rate swap agreement. All changes in the unrealized gains and losses on swap agreements designated as cash flow hedges have been recorded in accumulated other comprehensive income (loss) and are reclassified to earnings as interest expense is recognized on the Company's hedged borrowings. For interest rate swap agreements accounted for as cash flow hedges, the net amount accrued for the variable interest receivable and fixed interest payable affects the amount recorded as interest expense. If it becomes probable that the forecasted transaction, which in this case refers to interest payments to be made under the Company's short-term borrowing agreements, will not occur by the end of the originally specified time period, as documented at the inception of the hedging relationship, or within an additional two-month time period thereafter, then the related gain or loss in accumulated other comprehensive income (loss) would be reclassified to income. Certain swap agreements are designated as cash flow hedges against the benchmark interest rate risk associated with the Company's borrowings. Although the terms and characteristics of the Company's swap agreements and hedged borrowings are nearly identical, due to the explicit requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS No. 133 ), the Company does not account for these hedges under a method defined in SFAS No. 133 as the *shortcut* method, but rather the Company performs an assessment of the hedge effectiveness and measures the effectiveness of these hedges on an ongoing basis, and, to date, has calculated effectiveness of approximately 100%. The Company classifies and accounts for interest rate swap agreements that are not designated as cash flow hedges as free-standing derivatives. Accordingly, these swap agreements are recorded at fair value with changes in fair value recorded to current earnings as a component of (loss) gain on securities and derivatives as they are used to offset the price change exposure of mortgage-backed securities classified as trading. For interest rate swap agreements accounted for as free-standing derivatives, the net amount accrued for the variable interest receivable and fixed interest payable is recorded in current earnings as (loss) gain on securities and derivatives.





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***Termination of Hedging Relationships.*** The Company employs a number of risk management monitoring procedures to ensure that the designated hedging relationships are demonstrating, and are expected to continue to demonstrate, a high level of effectiveness. Hedge accounting is discontinued on a prospective basis if it is determined that the hedging relationship is no longer highly effective or expected to be highly effective in offsetting changes in fair value or cash flows of the hedged item. Additionally, the Company may elect to de-designate a hedge relationship during an interim period and re-designate upon the rebalancing of a hedge profile and the corresponding hedge relationship. When hedge accounting is discontinued, the Company continues to carry the derivative instruments at fair value with changes in their value recorded in earnings.

***Gain on Sale of Loans*** The Company recognizes gain on sale of loans, net of hedge gains or losses, for the difference between the sales price and the adjusted book value of the loans, less associated market valuation reserves and recourse liabilities, at the time of sale. The adjusted book value of the loans includes the original principal amount plus SFAS No. 133 basis adjustments plus deferrals of fees and points received and direct loan origination costs. Recourse liabilities could include the potential repurchase of loans or indemnification of losses based on violations of representations and warranties which are customary to the business. The Company's recourse liabilities are recorded in accrued expenses and other liabilities on the consolidated balance sheet.

The Company has elected to utilize the fair value option to measure mortgage loans held for sale originated after January 1, 2007, in accordance with SFAS No. 159. With the adoption of SFAS No. 159, the Company records in current earnings as gain on sale of loans its fair value in excess of cost basis of mortgage loans held for sale.

***Loan Origination Fees and Direct Origination Costs*** The Company records loan fees, discount points and certain direct origination costs as an adjustment of the cost of the loan or security and such amounts are included in revenues when the loan or security is sold or the loan is marked to fair value. When loans held for investment are securitized, net deferred origination costs are amortized over the life of the loan using the level-yield method and such amounts adjust interest income. When loans are securitized and held as trading securities, net deferred origination costs are an adjustment to the cost of the security and such amounts affect the amount recorded as (loss) gain on securities and derivatives.

***Interest Recognition*** The Company accrues interest income for all loans and securities as it is earned and interest expense as it is incurred. Loans are placed on a nonaccrual status when any portion of the principal or interest is 90 days past due or earlier when concern exists as to the ultimate collectibility of principal or interest. Loans return to accrual status when principal and interest become current and are anticipated to be fully collectible.

The Company enters into interest rate swap agreements which require it to pay a fixed interest rate and receive a variable interest rate based on the LIBOR. For interest rate swap agreements accounted for as cash flow hedges, the net amount accrued for the variable interest receivable and fixed interest payable affects the amount recorded as interest expense. For interest rate swap agreements accounted for as free-standing derivatives, the net amount accrued for the variable interest receivable and fixed interest payable is recorded in current earnings as (loss) gain on securities and derivatives.

***Servicing Fees*** The Company recognizes servicing fees when the fees are collected.

***Marketing and Promotion*** The Company charges the costs of marketing, promotion and advertising to expense in the period incurred.

***Income Taxes*** The Company accounts for income taxes in conformity with SFAS No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach for accounting and reporting of income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences ( temporary differences ) attributable to the differences between the carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. A valuation allowance is provided for deferred tax assets where realization is not considered more likely than not. The Company recognizes the effect of changes in tax laws or rates on deferred tax assets and liabilities in the period that includes the enactment date.

***Stock Option Plans*** Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, *Share Based Payment* ( SFAS No. 123R ), using the modified prospective method. Under this method, compensation cost includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (2) all share-based payments granted subsequent to December 31, 2005, based on the grant date fair value estimated using a binomial lattice-based option valuation model. The Company's policy is to recognize compensation cost for awards with only service conditions and a graded vesting schedule on a straight-line basis over the requisite service period for the entire award. Additionally, the Company's policy is to issue authorized but unissued shares of Common Stock to satisfy stock option exercises.



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**Earnings Per Share** Basic earnings per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted-average number of shares of Common Stock outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue Common Stock were exercised or converted into Common Stock or resulted in the issuance of Common Stock that then shared in the earnings of the Company.

**Cash Flows** Cash and cash equivalents are demand deposits and short-term investments with a maturity of 90 days or less.

**Recently Issued Accounting Standards** In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* ( SFAS No. 155 ). Key provisions of SFAS No. 155 include: (1) a broad fair value measurement option for certain hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation; (2) clarification that only the simplest separations of interest payments and principal payments qualify for the exception afforded to interest-only strips and principal-only strips from derivative accounting under paragraph 14 of SFAS No. 133 (thereby narrowing such exception); (3) a requirement that beneficial interests in securitized financial assets be analyzed to determine whether they are free standing derivatives or whether they are hybrid instruments that contain embedded derivatives requiring bifurcation; (4) clarification that concentrations of credit risk in the form of subordination are not embedded derivatives; and (5) elimination of the prohibition on a QSPE holding passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions, including interest-only strips and principal-only strips, required to be accounted for in accordance with SFAS No. 133. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after November 15, 2006. The adoption of SFAS No. 155 did not have a material effect on the Company's consolidated financial statements.

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of SFAS No. 109* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for financial statements issued for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material effect on the Company's consolidated financial statements.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statement* ( SAB 108 ), on quantifying financial statement misstatements. In summary, SAB 108 was issued to address the diversity in practice of evaluating and quantifying financial statement misstatements and the related accumulation of such misstatements. SAB 108 states that both a balance sheet approach and an income statement approach should be used when quantifying and evaluating the materiality of a potential misstatement and contains guidance for correcting errors under this dual perspective. SAB 108 is effective for financial statements issued for fiscal years ending after November 15, 2006. The adoption of SAB 108 did not have a material effect on the Company's consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, which provides for enhanced guidance for using the fair value to measure assets and liabilities. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ( GAAP ), and expands disclosures about fair value measurements. SFAS No. 157 is applicable under other accounting pronouncements that either require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

Effective January 1, 2007, the Company adopted the methods of fair value as prescribed in SFAS No. 157 to value financial assets and liabilities. As defined in SFAS No. 157, fair value is based on exit price or the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs used when little or no market data is available.

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The Company has applied this definition of fair value in conjunction with its adoption of SFAS No. 159.

In February 2007, the FASB issued SFAS No. 159, which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both complexity in accounting for financial instruments and the volatility in

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earnings caused by measuring related assets and liabilities differently. SFAS No. 159 establishes presentation and disclosure requirements and requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of a company's choice to use fair value on its earnings. SFAS No. 159 also requires entities to display the fair value of those assets and liabilities for which the entity has chosen to use fair value on the face of the balance sheet. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and early adoption is permitted for fiscal years beginning on or before November 15, 2007 provided that the entity makes that choice in the first 120 days of the fiscal year, has not issued financial statements for any interim period of the fiscal year of adoption and also elects to apply the provisions of SFAS No. 157. Effective January 1, 2007, the Company is electing to utilize the fair value option to value a portion of its mortgage loans held for sale and substantially all of its marketable securities. The Company did not elect the fair value option for its mortgage loans held for sale held as of December 31, 2006 due to cost-benefit considerations.

**NOTE 2 CASH AND CASH EQUIVALENTS**

Cash and cash equivalents are demand deposits and short-term investments with a maturity of 90 days or less. The carrying amount of cash and cash equivalents approximates its fair value.

Included within cash and cash equivalents are reserve balances that the Company is required to maintain due to contractual or fiduciary obligations. These restrictions include funds collected for various escrow responsibilities, including funds held for tax and insurance collections. The Company's reserved funds as of March 31, 2007, and December 31, 2006 are \$310.1 million and \$218.1 million, respectively.

**NOTE 3 FAIR VALUE**

The following tables present the Company's financial assets and liabilities that were accounted for at fair value as of March 31, 2007 by level within the fair value hierarchy. As required by SFAS No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	March 31, 2007			Total
	Level 1	Level 2	Level 3	
(In thousands)				
Securities	\$	\$ 7,556,464	\$	\$ 7,556,464
Mortgage loans held for sale	271,338	3,654,958		3,926,296
Derivative assets		22,718		22,718
Mortgage servicing rights		525,565		525,565
Total assets at fair value	\$ 271,338	\$ 11,759,705	\$	\$ 12,031,043

	March 31, 2007			Total
	Level 1	Level 2	Level 3	
(In thousands)				
Derivative liabilities	\$	\$ 36,550	\$	\$ 36,550
Total liabilities at fair value	\$	\$ 36,550	\$	\$ 36,550

The Company elected to early adopt SFAS No. 159 as of January 1, 2007, and in doing so, began employing the use of fair value measurement for a portion of its mortgage loans held for sale and its marketable securities. The Company has elected to utilize the fair value option to measure mortgage loans held for sale originated after January 1, 2007. With the adoption of SFAS No. 159, the Company recognized a gain of approximately \$44.8 million during the three months ended March 31, 2007, related to the fair value in excess of cost basis of mortgage loans held for sale. The Company's cost basis adjustments relating to the adoption of SFAS No. 159 were \$52.1 million during the three months ended March 31, 2007.



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The Company's primary reasons for electing the fair value option were mitigating volatility in earnings from different measurement attributes, simplification, and cost-benefit considerations. The transition adjustment to beginning retained earnings related to the adoption of SFAS No. 159 was a loss of \$54.5 million, net of tax, all of which related to applying the fair value option to securities.

**NOTE 4 SECURITIES**

The following table presents the Company's securities as of March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
(In thousands)		
Mortgage-backed securities:		
Agency	\$ 354,935	\$ 212,591
Privately issued rated	7,018,617	8,887,249
Privately issued unrated	180,128	204,710
Total mortgage-backed securities	7,553,680	9,304,550
Fannie Mae bonds	1,994	1,979
Corporate bonds	186	188
Trust preferred securities	592	593
Equity securities	12	13
Total securities at fair value	7,556,464	9,307,323
FHLB stock, at cost	1,422	709
Total securities	\$ 7,557,886	\$ 9,308,032

The Company's securities held at March 31, 2007 were primarily either agency obligations or were rated AAA or AA by Standard & Poor's.

A substantial portion of the Company's securitizations qualified as sales under SFAS No. 140, which resulted in the recording of residual assets and MSR's on the consolidated balance sheet. The principal balance of off-balance sheet securitized loans that the Company has securitized privately was \$12.0 billion and \$10.7 billion as of March 31, 2007 and December 31, 2006, respectively. The credit exposure associated with the Company's off-balance sheet securitized loans is limited to the fair value of the Company's residual assets from securitizations totaling \$182.9 million and \$206.1 million as of March 31, 2007 and December 31, 2006, respectively. As of March 31, 2007, the Company's nonperforming off-balance sheet securitized loans were \$310.1 million, or 2.59% of the total portfolio. As of December 31, 2006, the Company's nonperforming off-balance sheet securitized loans were \$266.0 million, or 2.48% of the total portfolio.

The significant assumptions used in estimating the fair value of residual cash flows as of March 31, 2007 and December 31, 2006 were as follows:

	March 31, 2007	December 31, 2006
Weighted-average prepayment speed (CPR)	28.70%	30.48%
Weighted-average discount rate	19.03%	16.74%
Weighted-average annual default rate	0.83%	0.63%
Weighted-average loss severity	21.11%	22.33%





**Table of Contents****NOTE 5 MORTGAGE LOANS****Mortgage Loans Held For Sale, at Fair Value**

The following table presents the Company's mortgage loans held for sale, at fair value, as of March 31, 2007:

	March 31,
(In thousands)	2007
Mortgage loans held for sale	\$ 3,829,365
Mark to fair value equal to cost basis adjustments	52,100
Mark to fair value in excess of cost basis adjustments	44,831
 Total mortgage loans held for sale, at fair value	 \$ 3,926,296

At March 31, 2007, the Company marked to fair value \$3.8 billion of mortgage loans held for sale and recognized a gain of approximately \$44.8 million related to the fair value in excess of cost basis on mortgage loans held for sale. The Company's cost basis adjustments relating to the direct costs of originating the loans were \$52.1 million during the three months ended March 31, 2007.

As of March 31, 2007, the Company held no mortgage loans held for sale, at fair value, which were contractually past due 90 days or more as to principal or interest payments.

**Mortgage Loans Held For Sale, Net**

The following table presents the Company's mortgage loans held for sale, net, as of March 31, 2007 and December 31, 2006:

	March 31,	December 31,
(In thousands)	2007	2006
Mortgage loans held for sale	\$ 1,001,815	\$ 1,533,613
SFAS No. 133 basis adjustments	(1,199)	(2,467)
Deferred origination costs, net	7,650	14,639
LOCOM valuation reserves	(52,815)	(22,048)
 Total mortgage loans held for sale, net	 \$ 955,451	 \$ 1,523,737

During the three months ended March 31, 2007, the Company sold or added at fair value mortgage loans totaling \$17.2 billion and realized \$126.8 million in gains.

During the three months ended March 31, 2006, the Company sold mortgage loans totaling \$13.5 billion and realized \$171.9 million in gains.

During the three months ended March 31, 2007, the Company deferred \$253.1 million of loan origination costs as an adjustment to the cost basis for additions to mortgage loans held for sale. The Company's gain on sale of loans was reduced by \$208.0 million of deferred origination costs associated with mortgage loans sold and \$52.1 million of cost basis adjustments for mortgage loans held for sale at fair value during the three months ended March 31, 2007.

During the three months ended March 31, 2006, the Company deferred \$127.9 million of loan origination costs as an adjustment to the cost basis for additions to mortgage loans held for sale. The Company's gain on sale of loans was reduced by \$134.7 million of deferred origination costs associated with mortgage loans sold during the three months ended March 31, 2006.

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As of March 31, 2007, the Company's nonaccruing mortgage loans held for sale was \$242.9 million, or 5.03% of the total mortgage loans held for sale portfolio. As of December 31, 2006, the Company's nonaccruing mortgage loans held for sale was \$124.3 million, or 8.13% of the total mortgage loans held for sale portfolio.

As of March 31, 2007 and December 31, 2006, the Company held no accruing mortgage loans held for sale which were contractually past due 90 days or more as to principal or interest payments.

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**Table of Contents****Mortgage Loans Held For Investment, Net**

The following table presents the Company's mortgage loans held for investment, net, as of March 31, 2007 and December 31, 2006:

(In thousands)	March 31, 2007	December 31, 2006
Mortgage loans held for investment:		
One-to-four family	\$ 5,964,664	\$ 6,276,890
Commercial	4,562	4,580
 Mortgage loans held for investment	 5,969,226	 6,281,470
SFAS No. 133 basis adjustments	(2,736)	(2,967)
Deferred origination costs, net	61,065	65,409
Allowance for loan losses	(16,586)	(14,191)
 Total mortgage loans held for investment, net	 \$ 6,010,969	 \$ 6,329,721

During the three months ended March 31, 2007, the Company deferred \$361.1 thousand of loan origination costs as an adjustment to the cost basis for mortgage loans added to its held for investment portfolio. The Company's interest income was reduced by \$4.7 million of deferred origination cost amortization on mortgage loans held for investment during the three months ended March 31, 2007.

During the three months ended March 31, 2006, the Company deferred \$8.4 million of loan origination costs as an adjustment to the cost basis for mortgage loans added to its held for investment portfolio. The Company's interest income was reduced by \$2.8 million of deferred origination cost amortization on mortgage loans held for investment during the three months ended March 31, 2006.

As of March 31, 2007, the Company's mortgage loans held for investment includes \$4.9 billion of mortgage loans pledged as collateral for its collateralized debt obligations.

As of December 31, 2006, the Company's mortgage loans held for investment includes \$5.0 billion of mortgage loans pledged as collateral for its collateralized debt obligations.

The following table presents the activity in the Company's allowance for loan losses for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31, 2007	2006
	(In thousands)	
Balance at beginning of period	\$ 14,191	\$ 2,142
Provision for loan losses	9,143	1,311
Charge-offs	(6,748)	
 Balance at end of period	 \$ 16,586	 \$ 3,453

As of March 31, 2007, the Company's nonaccruing mortgage loans held for investment was \$96.1 million, or 1.61% of the total mortgage loans held for investment portfolio. As of December 31, 2006, the Company's nonaccruing mortgage loans held for investment was \$82.4 million, or 1.31% of the total mortgage loans held for investment portfolio.

As of March 31, 2007 and December 31, 2006, the Company held no accruing loans held for investment which were contractually past due 90 days or more as to principal or interest payments.



**Table of Contents****NOTE 6 DERIVATIVE ASSETS AND LIABILITIES**

The following table presents the Company's derivative assets and liabilities as of March 31, 2007 and December 31, 2006:

(In thousands)	March 31, 2007	December 31, 2006
<b>Derivative Assets</b>		
Interest rate lock commitments	\$ 13,524	\$ 11,728
Interest rate swaps	5,556	9,759
Swaptions	2,185	2,367
Forward delivery contracts loan commitments		4,253
Forward delivery contracts loans held for sale		2,342
Other	1,453	1,693
 Derivative assets	 \$ 22,718	 \$ 32,142
<b>Derivative Liabilities</b>		
Interest rate swaps	\$ 24,323	\$ 1,624
Forward delivery contracts loan commitments	2,903	
Total return swaps	2,725	3,178
Forward delivery contracts loans held for sale	2,282	
Interest rate lock commitments	733	7,842
Other	3,584	
 Derivative liabilities	 \$ 36,550	 \$ 12,644

As of March 31, 2007 and December 31, 2006, the notional amount of forward delivery contracts was approximately \$7.6 billion and \$4.8 billion, respectively.

As of March 31, 2007 and December 31, 2006, the notional amount of interest rate swap agreements was approximately \$5.2 billion and \$8.4 billion, respectively.

As of March 31, 2007 and December 31, 2006, the notional amount of swaptions was approximately \$380.0 million.

As of March 31, 2007 and December 31, 2006, the notional amount of total return swaps was approximately \$148.7 million and \$152.6 million, respectively.

The Company's forward delivery contracts have a high correlation to the price movement of the loans being hedged. The ineffectiveness in hedging loans held for sale recorded on the consolidated balance sheets was insignificant as of March 31, 2007 and December 31, 2006.

The unrealized loss on interest rate swap agreements, interest rate caps and other derivative liabilities relating to cash flow hedges recorded in accumulated other comprehensive loss was \$49.7 million and \$30.7 million as of March 31, 2007 and December 31, 2006, respectively. During the three months ended March 31, 2007, the increase in unrealized loss on cash flow hedges, net of amortization, was \$19.0 million. During the three months ended March 31, 2006, the increase in unrealized gain on cash flow hedges, net of amortization, was \$49.8 million. These changes in unrealized gain and loss on cash flow hedges are reported in net change in accumulated other comprehensive loss in the consolidated statements of stockholders' equity.

The Company estimates that \$6.4 million of the unrealized loss as of March 31, 2007 will be reclassified from accumulated other comprehensive loss to interest expense for the twelve months ended March 31, 2008.

**Table of Contents****NOTE 7 MORTGAGE SERVICING RIGHTS**

The Company elected to early adopt SFAS No. 156 as of January 1, 2006, and has recorded its MSR's at fair value. The Company's adoption of SFAS No. 156 resulted in a cumulative-effect adjustment as of January 1, 2006, which increased MSR's by \$1.2 million.

Prior to January 1, 2006, MSR's were carried at the lower of cost or fair value, based on defined interest rate risk strata, and the gross MSR asset was amortized in proportion to and over the period of estimated net servicing income. Prior to the Company's adoption of SFAS No. 156, the Company evaluated MSR's for impairment based on risk strata and a valuation allowance was recognized for MSR's that had an amortized balance in excess of the estimated fair value for the individual risk stratification.

The following table presents the activity in the Company's MSR's for the three months ended March 31, 2007 and 2006:

(In thousands)	Three Months Ended March 31,	
	2007	2006
Balance at beginning of period	\$ 506,341	\$ 340,377
Cumulative-effect adjustment as of beginning of year		1,156
Fair value measurement method adjustment		(20,706)
Additions	45,645	69,768
Changes in fair value resulting from:		
Realization of cash flows	(24,959)	(18,735)
Changes in valuation assumptions	(1,462)	114
Balance at end of period	\$ 525,565	\$ 371,974
Impairment allowance:		
Balance at beginning of period	\$	\$ (20,706)
Fair value measurement method adjustment		20,706
Balance at end of period	\$	\$
Total mortgage servicing rights	\$ 525,565	\$ 371,974

The amount of contractually specified servicing fees earned by the Company during the three months ended March 31, 2007 and 2006 were \$33.1 million and \$20.3 million, respectively.

The estimated fair value of MSR's is determined by obtaining a market valuation from one of the market's primary independent MSR brokers. To determine the market value of MSR's, the MSR broker uses a valuation model which incorporates assumptions relating to the estimate of the cost of servicing the loan, a discount rate, a float value, an inflation rate, ancillary income per loan, prepayment speeds and default rates that market participants use for similar MSR's. Market assumptions are held constant over the life of the portfolio. The key risks inherent in MSR's are changes in interest rates and prepayment speeds.

The Company uses free standing derivatives to hedge the risk of changes in fair value of MSR's, with the resulting gain or loss reflected in income. During the three months ended March 31, 2007, the Company recognized in earnings \$387 thousand in unrealized gains on free standing derivatives used to economically hedge the MSR's. These gains are recorded in change in fair value of mortgage servicing rights due to changes in valuation assumptions, net of hedge gain, in the consolidated statements of income.

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The significant assumptions used in estimating the fair value of MSRs at March 31, 2007 and December 31, 2006 were as follows:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
Weighted-average prepayment speed (PSA)	488	487
Weighted-average discount rate	11.69%	11.50%
Weighted-average default rate	2.30%	2.56%

The following table presents certain information regarding the Company's servicing portfolio of loans serviced for others at March 31, 2007 and December 31, 2006:

	<b>March 31, 2007</b>	<b>December 31, 2006</b>
	<b>(Dollars in thousands)</b>	
Loan servicing portfolio loans sold or securitized	\$ 39,631,213	\$ 38,480,246
ARM loans as a percentage of total loans	76%	76%
Average loan size	\$ 247	\$ 241
Weighted-average servicing fee	0.348%	0.347%
Weighted-average note rate	7.30%	7.08%
Weighted-average remaining term (in months)	371	369
Weighted-average age (in months)	17	15

**Table of Contents****NOTE 8 GOODWILL**

The following table presents the activity in the Company's goodwill for the three months ended March 31, 2007 and 2006:

	Loan Origination	Mortgage Holdings	Banking	
(In thousands)	Segment	Segment	Segment	Total
Balance at January 1, 2006	\$ 74,687	\$ 24,840	\$	\$ 99,527
Acquisitions	700			700
Earnouts from previous acquisitions	10,103			10,103
Balance at March 31, 2006	\$ 85,490	\$ 24,840	\$	\$ 110,330
Balance at January 1, 2007	\$ 87,050	\$ 24,840	\$ 21,238	\$ 133,128
Earnouts from previous acquisitions	120			120
Balance at March 31, 2007	\$ 87,170	\$ 24,840	\$ 21,238	\$ 133,248

In October 2006, the Company, through its wholly-owned subsidiary American Home Mortgage Holdings, Inc., acquired Flower Bank, fsb, now known as American Home Bank ( AH Bank ). The goodwill relating to the AH Bank acquisition was \$21.2 million. The details of the AH Bank acquisition are included in Note 21 to the Consolidated Financial Statements ( Acquisitions ).

As of December 31, 2006, the Company completed a goodwill impairment test by comparing the fair value of goodwill with its carrying value and did not recognize impairment.

**NOTE 9 WAREHOUSE LINES OF CREDIT, REVERSE REPURCHASE AGREEMENTS AND COMMERCIAL PAPER****Warehouse Lines of Credit**

To originate a mortgage loan, the Company draws against either a \$3.3 billion SLN commercial paper program, a \$2.0 billion pre-purchase facility with UBS Real Estate Securities Inc., a facility of \$2.0 billion with Bear Stearns, a \$1.3 billion bank syndicated facility led by Bank of America, N.A. (which includes a \$446 million term loan facility which the Company uses to finance its MSR's), a facility of \$125 million with J.P. Morgan Chase, a \$750 million facility with IXIS Real Estate Capital, Inc. ( IXIS ), a \$350 million facility with Credit Suisse First Boston Mortgage Capital LLC ( CSFB ), a \$1.0 billion facility with Barclays Bank PLC ( Barclays ), a \$250 million facility with ABN AMRO, or a \$1.5 billion syndicated facility led by Calyon New York Branch ( Calyon ). The Bank of America, J.P. Morgan Chase, ABN AMRO, and Calyon facilities are committed facilities. The IXIS and CSFB facilities are partially committed facilities. The interest rate on outstanding balances fluctuates daily based on a spread to the LIBOR and interest is paid monthly. In addition, we have purchase and sale gestation facilities with UBS, Greenwich Capital Financial Products, Inc. ( Greenwich ), Societe Generale, and Deutsche Bank ( Deutsche ). The facilities are secured by mortgage loans and other assets of the Company.

The facilities contain various covenants pertaining to maintenance of net worth, working capital and maximum leverage. At March 31, 2007, the Company was in compliance with respect to the loan covenants.

Included within the Bank of America line of credit, the Company has a working capital sub-limit that allows for borrowings up to \$50 million at a rate based on a spread to the LIBOR that may be adjusted for earnings on compensating balances on deposit at creditors' banks. As of March 31, 2007, borrowings under the working capital line of credit were \$50.0 million.



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The following tables summarize the Company's warehouse lines of credit:

	March 31, 2007 (Dollars in thousands)	December 31, 2006 (Dollars in thousands)
Balance outstanding at end of period	\$ 4,013,190	\$ 1,304,541
Weighted-average interest rate at end of period	5.65%	5.94%
	Three Months Ended March 31, 2007 (In thousands)	
Average balance outstanding for the period	\$ 7,224,668	\$ 6,713,022
Maximum balance outstanding at any month end	5,194,848	5,028,564

As of March 31, 2007 and December 31, 2006, the Company's warehouse lines of credit had remaining maturities within 30 days.

## Reverse Repurchase Agreements

The Company has arrangements to enter into reverse repurchase agreements, a form of collateralized short-term borrowing, with eighteen different financial institutions and on March 31, 2007 had borrowed funds from eleven of these firms. Because the Company borrows money under these agreements based on the fair value of its mortgage-backed securities, and because changes in interest rates can negatively impact the valuation of mortgage-backed securities, the Company's borrowing ability under these agreements could be limited and lenders could initiate margin calls in the event interest rates change or the value of the Company's mortgage-backed securities declines for other reasons.

The following tables summarize the Company's reverse repurchase agreements:

	March 31, 2007 (Dollars in thousands)	December 31, 2006 (Dollars in thousands)
Balance outstanding at end of period	\$ 6,727,505	\$ 8,571,459
Weighted-average interest rate at end of period	5.38%	5.40%
	Three Months Ended March 31, 2007 (In thousands)	
Average balance outstanding for the period	\$ 8,533,063	\$ 9,309,261
Maximum balance outstanding at any month end	9,199,441	9,126,012

As of March 31, 2007 and December 31, 2006, the Company's reverse repurchase agreements had the following remaining maturities:

	March 31, 2007 (In thousands)	December 31, 2006 (In thousands)
Within 30 days	\$ 403,868	\$ 511,095
31 to 89 days	347,631	684,774
90 to 365 days	5,050,381	2,499,057
Greater than 1 year	925,625	4,876,533

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Total reverse repurchase agreements	\$ 6,727,505	\$ 8,571,459
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As of March 31, 2007 and December 31, 2006, the Company's reverse repurchase agreements outstanding had a weighted-average remaining maturity of nine months and eleven months, respectively.

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**Table of Contents****Commercial Paper**

The Company maintains a wholly owned special purpose entity for the purpose of issuing commercial paper in the form of short-term SLNs to finance certain portions of the Company's mortgage loans. The special purpose entity allows for issuance of short-term SLNs with maturities of up to 180 days, extendable up to 300 days. The SLNs bear interest at prevailing money market rates approximating the LIBOR. The SLN program capacity, based on aggregate commitments of underlying credit enhancers, was \$3.3 billion at March 31, 2007.

The SLNs were collateralized by mortgage loans held for sale, mortgage loans held for investment and cash with a balance of \$1.8 billion as of March 31, 2007. The SLNs were collateralized by mortgage loans held for sale, mortgage loans held for investment and cash with a balance of \$1.4 billion as of December 31, 2006.

The following tables summarize the Company's SLNs:

	March 31, 2007 (Dollars in thousands)	December 31, 2006 (Dollars in thousands)
Balance outstanding at end of period	\$ 1,696,256	\$ 1,273,965
Weighted-average interest rate at end of period	5.37%	5.39%

  

	Three Months Ended March 31, 2007 (In thousands)	2006 (In thousands)
Average balance outstanding for the period	\$ 2,557,841	\$ 2,666,665
Maximum balance outstanding at any month end	2,751,799	3,095,867

As of March 31, 2007 and December 31, 2006, the Company's SLNs had remaining maturities within 30 days.

**NOTE 10 DEPOSITS**

The Company assumed \$30.7 million of deposits in connection with its acquisition of AH Bank. The following table presents the Company's deposits as of March 31, 2007 and December 31, 2006:

	March 31, 2007 (In thousands)	December 31, 2006 (In thousands)
Checking deposits:		
Non-interest bearing	\$ 822	\$ 1,168
Interest bearing	84	82
Checking deposits	906	1,250
Savings deposits	18	8
Money market deposits	163,169	192
Time deposits	20,521	22,566
Total deposits	\$ 184,614	\$ 24,016

The Company's accrued but unpaid interest on deposits totaled \$65 thousand as of March 31, 2007 and \$95 thousand as of December 31, 2006.



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The Company's time deposit accounts in amounts of \$100,000 or more totaled \$2.3 million as of March 31, 2007 and December 31, 2006. The following table presents the contractual maturities of the Company's time deposits in amounts of \$100,000 or more as of March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
	(In thousands)	
90 to 180 days	\$ 677	\$ 356
180 days to 1 year	1,065	1,267
Greater than 1 year	527	631
Total	\$ 2,269	\$ 2,254

There were no demand deposits with overdrafts as of March 31, 2007 and December 31, 2006.

**NOTE 11 COLLATERALIZED DEBT OBLIGATIONS**

In March 2007, the Company issued \$161.9 million of CDOs in the form of AAA and AA-rated floating-rate pass-through certificates to third-party investors. The interest rates on the floating-rate pass-through certificates reset monthly and are indexed to one-month LIBOR. In the first quarter of 2007, the Company incurred CDO issuance costs of \$1.5 million related to this transaction, which were deducted from the proceeds of the transactions and are being amortized over the expected life of the CDOs.

In March 2006, the Company issued \$1.9 billion of CDOs in the form of AAA and AA-rated floating-rate pass-through certificates to third-party investors. The interest rates on the floating-rate pass-through certificates reset monthly and are indexed to one-month LIBOR. In the first quarter of 2006, the Company incurred CDO issuance costs of \$4.0 million, which were deducted from the proceeds of the transactions and are being amortized over the expected life of the CDOs.

As of March 31, 2007, the Company's CDOs had a balance of \$4.7 billion and an effective interest cost of 5.50%. As of March 31, 2007, the CDOs were collateralized by mortgage loans held for investment of \$4.7 billion.

As of December 31, 2006, the Company's CDOs had a balance of \$4.9 billion and an effective interest cost of 5.53%. As of December 31, 2006, the CDOs were collateralized by mortgage loans held for investment of \$4.9 billion.

As of March 31, 2007 and December 31, 2006, the Company's CDOs had the following remaining contractual maturities:

	March 31, 2007	December 31, 2006
	(In thousands)	
15 to 20 years	\$ 24,735	\$ 30,927
20 to 25 years	173,976	151,957
25 to 30 years	1,644,089	1,678,306
Greater than 30 years	2,876,576	2,993,611
Total collateralized debt obligations	\$ 4,719,376	\$ 4,854,801

**NOTE 12 TRUST PREFERRED SECURITIES**

As of March 31, 2007, the Company has formed eight Trusts for the purpose of issuing trust preferred securities.

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The Company's trust preferred securities outstanding as of March 31, 2007 and December 31, 2006 were \$336.6 million and \$336.1 million, respectively.

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The following table summarizes the Company's trust preferred securities:

	Three Months Ended March 31,	
	2007	2006
Weighted-average interest rate	8.09%	7.66%
Weighted-average interest rate spread	LIBOR + 2.74%	LIBOR + 2.92%
Weighted-average remaining maturity (years)	28.96	29.58

## NOTE 13 NOTES PAYABLE

Notes payable primarily consist of amounts borrowed under a term loan facility with a bank syndicate led by Bank of America. Under the terms of this facility, the Company may borrow the lesser of 70% of the value of its MSRs, or \$446.3 million. As of March 31, 2007, borrowings under the term loan were \$391.7 million. This term loan expires on August 9, 2007, but the Company has an option to extend the term for twelve additional months at a higher interest rate. Interest is based on a spread to the LIBOR and may be adjusted for earnings on compensating balances. As of March 31, 2007, the interest rate was 6.07%.

In October 2006, the Company assumed \$3.0 million of subordinated notes in connection with its acquisition of AH Bank. The subordinated notes mature on December 8, 2011. The interest rates on the subordinated notes reset monthly and are indexed to six-month LIBOR. As of March 31, 2007, the interest rate was 9.10%.

In 2005, the Company sold \$85.0 million in Mortgage Warehouse Subordinated Notes ( Subordinated Notes ). The Company received a premium, net of issuance costs, of \$1.5 million related to the Subordinated Notes offering, which is being amortized to interest expense over the expected life of the Subordinated Notes. As of March 31, 2007, the balance of Subordinated Notes outstanding, net of unamortized premium and issuance costs, was \$85.8 million. The Subordinated Notes mature on May 20, 2009. The interest rates on the Subordinated Notes reset monthly and are indexed to one-month LIBOR. As of March 31, 2007, the interest rate was 7.32%.

As of March 31, 2007, included in notes payable is a mortgage note of \$25.4 million on an office building located in Melville, New York at a rate of 5.82%, and a mortgage note of \$0.9 million on an office building located in Mount Prospect, Illinois at a rate of 7.18%.

As of March 31, 2007, the Company had \$25.0 million of Federal Home Loan Bank ( FHLB ) advances with an interest rate of 5.39% and with remaining maturities within 30 days. Advances from the FHLB are collateralized by pledges of restricted cash of \$46.6 million.

The following table presents the Company's notes payable as of March 31, 2007 and December 31, 2006:

(In thousands)	March 31, 2007	December 31, 2006
Term loan	\$ 391,700	\$ 298,500
Subordinated notes	88,817	88,910
Notes office buildings	26,350	26,457
FHLB advances	25,000	3,600
Total notes payable	\$ 531,867	\$ 417,467

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The following table presents the maturities of the Company's notes payable as of March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
	(In thousands)	
Within 1 year	\$ 417,557	\$ 302,953
1 to 2 years	1,626	1,629
2 to 3 years	85,486	85,573
3 to 4 years	454	447
4 to 5 years	3,478	3,475
Greater than 5 years	23,266	23,390
Total notes payable	\$ 531,867	\$ 417,467

## NOTE 14 COMMON STOCK AND PREFERRED STOCK

Under the Company's charter, the Company's Board of Directors is authorized to issue 110,000,000 shares of stock, of which up to 100,000,000 shares may be Common Stock and up to 10,000,000 shares may be preferred stock. As of March 31, 2007, there were 50,273,878 shares of Common Stock issued and outstanding, 2,150,000 shares of 9.75% Series A Cumulative Redeemable Preferred Stock (Series A Preferred Stock) issued and outstanding and 3,450,000 shares of 9.25% Series B Cumulative Redeemable Preferred Stock (Series B Preferred Stock) issued and outstanding. On or after July 7, 2009, the Company may, at its option, redeem the Series A Preferred Stock, in whole or part, at any time and from time to time, for cash at a price of \$25 per share, plus accumulated or unpaid dividends (whether or not declared), if any, to the date of redemption. On or after December 15, 2009, the Company may, at its option, redeem the Series B Preferred Stock, in whole or part, at any time and from time to time, for cash at a price of \$25 per share, plus accumulated or unpaid dividends (whether or not declared), if any, to the date of redemption.

During the three months ended March 31, 2007, the Company declared dividends totaling \$56.3 million, or \$1.12 per share of Common Stock, which were paid on April 27, 2007. During the three months ended March 31, 2006, the Company declared dividends totaling \$45.5 million, or \$0.91 per share of Common Stock, which were paid on April 28, 2006.

During the three months ended March 31, 2007, the Company declared dividends totaling \$1.3 million, or \$0.609375 per share of Series A Preferred Stock, which were paid on April 30, 2007. During the three months ended March 31, 2006, the Company declared dividends totaling \$1.3 million, or \$0.609375 per share of Series A Preferred Stock, which were paid on May 1, 2006.

During the three months ended March 31, 2007, the Company declared dividends totaling \$2.0 million, or \$0.578125 per share of Series B Preferred Stock, which were paid on April 30, 2007. During the three months ended March 31, 2006, the Company declared dividends totaling \$2.0 million, or \$0.578125 per share of Series B Preferred Stock, which were paid on May 1, 2006.



**Table of Contents****NOTE 15 INCOME TAXES**

A reconciliation of the statutory income tax provision to the effective income tax (benefit) expense is as follows:

	Three Months Ended March 31,			
	2007		2006	
	(Dollars in thousands)			
Tax provision at statutory rate	\$ 6,303	35.0%	\$ 24,731	35.0%
Non-taxable REIT income	(18,562)	(103.1)	(10,989)	(15.6)
State and local taxes, net of federal income tax benefit	(1,412)	(7.8)	1,997	2.8
Meals and entertainment	278	1.5	461	0.7
Other	718	4.0		
Income tax (benefit) expense	\$ (12,675)	(70.4%)	\$ 16,200	22.9%

The major sources of temporary differences and their deferred tax effect at March 31, 2007 and December 31, 2006 are as follows:

	March 31,	December 31,
	2007	2006
	(In thousands)	
Deferred income tax liabilities:		
Capitalized cost of mortgage servicing rights	\$ 192,933	\$ 179,545
Loan origination costs	22,302	29,651
Depreciation		1,482
Deferred state income taxes		2,332
Mark-to-market adjustments	16,247	13,783
Other	2,992	
Deferred income tax liabilities	234,474	226,793
Deferred income tax assets:		
Tax loss carryforwards	92,560	89,298
Allowance for bad debts and foreclosure reserve	23,284	16,909
Mark-to-market adjustments	2,835	
AMT credit	1,745	1,745
Bonus accrual	13,152	1,227
Deferred compensation	7,651	7,004
Depreciation	765	
Other		186
Deferred income tax assets	141,992	116,369
Net deferred income tax liabilities	\$ 92,482	\$ 110,424

American Home Mortgage Servicing, Inc. has approximately \$26 million of separate company federal net operating loss carryforwards which begin to expire in 2008. In addition, American Home Mortgage Holdings, Inc. has approximately \$234 million of federal and approximately \$119 million of state net operating loss carryforwards which begin to expire in 2024 and 2009, respectively. The weighted average of the expiration of the state net operating loss carryforwards is approximately fifteen years.

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At March 31, 2007 and December 31, 2006, no valuation allowance has been established against deferred tax assets since it is more likely than not that the deferred tax assets will be realized.

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The Company has been audited by various state tax jurisdictions which have settled with a no change decision or an immaterial assessment. In addition, the Company is currently under examination by other tax jurisdictions which the Company expects to result in no material assessments. The Company regularly assesses the likelihood of additional assessments in each of the tax jurisdictions in the calculation of its provision and maintains an appropriate reserve as needed.

The Company has evaluated FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Interest and penalties are accrued and reported as interest expenses and other expenses on the consolidated statement of income. In addition, the 2003-2006 tax years remain open to examination by the major taxing jurisdictions. As of March 31, 2007, the adoption of FIN 48 has had no material impact on the Company's consolidated financial statements.

**NOTE 16 EARNINGS PER SHARE**

The following is a reconciliation of the denominators used in the computations of basic and diluted earnings per share for the three months ended March 31, 2007 and 2006:

(Dollars in thousands, except per share amounts)	Three Months Ended March 31,	
	2007	2006
Numerator for basic earnings per share - Net income available to common stockholders	\$ 27,377	\$ 51,154
Denominator:		
Denominator for basic earnings per share		
Weighted average number of common shares outstanding during the period	50,222,881	49,715,423
Net effect of dilutive stock options	276,026	354,813
Denominator for diluted earnings per share	50,498,907	50,070,236
Net income per share available to common stockholders:		
Basic	\$ 0.55	\$ 1.03
Diluted	\$ 0.54	\$ 1.02

**NOTE 17 STOCK INCENTIVE PLANS**

Pursuant to the Company's 1999 Omnibus Stock Incentive Plan (the Plan), eligible employees, officers and directors may be offered the opportunity to acquire the Company's Common Stock through the grant of options and the award of restricted stock under the Plan. The total number of shares that may be optioned or awarded under the Plan is 4,000,000 shares of Common Stock. The Plan provides for the granting of options at the fair market value on the date of grant. The options issued primarily vest 50% on the two-year anniversary of the grant date and 50% on the three-year anniversary of the grant date, and expire ten years from the grant date.

Effective January 1, 2006, the Company adopted SFAS No. 123R, which requires that the compensation cost relating to share-based payment transactions (including employee stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans) be recognized as an expense in the Company's consolidated financial statements. Under SFAS No. 123R, the related compensation cost is measured based on the fair value of the award at the date of grant. The Company adopted the fair value recognition provisions of SFAS No. 123R, using the modified prospective method. Under this method, compensation cost in the three months ended March 31, 2007 and March 31, 2006 includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested as of, December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and (2) all share-based payments granted subsequent to December 31, 2005, based on the grant date fair value estimated using a binomial lattice-based option valuation model.



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During the three months ended March 31, 2007 and 2006, the Company recognized compensation expense of \$322 thousand and \$410 thousand, respectively, relating to stock options granted under the Plan. The expense, before income tax effect, is included in salaries, commissions and benefits expense. The income tax benefit recognized in income for the three months ended March 31, 2007 and 2006 for stock options was \$62 thousand and \$101 thousand, respectively.

During the three months ended March 31, 2007 and 2006, the fair value of the options granted was estimated using the binomial lattice option-pricing model. Under the binomial lattice option-pricing model, the fair value of each option award is estimated, with the assistance of an outside consulting service, on the date of grant, which incorporates ranges of assumptions for inputs as shown in the following table. The assumptions are as follows:

*Dividend yield range:* The expected dividend yield assumption is based on the Company's current dividend yield as the best estimate of projected dividend yield for periods within the contractual life of the option.

*Expected volatility range:* The expected volatility assumption is a blend of implied volatility based on market-traded options on the Company's Common Stock and historical volatility of the Company's Common Stock over the contractual life of the options.

*Risk-free interest rate range:* The risk-free interest rate assumption is based on the U.S. Treasury yield curve in effect at the time of grant for periods within the contractual life of the option.

*Expected term range:* The Company uses historical data to estimate option exercise and employee termination behavior within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected life of options granted is derived from the output of the option valuation model and represents the period of time the options are expected to be outstanding.

The weighted-average fair value per share of options granted during the three months ended March 31, 2007 and 2006 was \$3.39 and \$4.57, respectively. The fair value of the options granted during the three months ended March 31, 2007 and 2006 was estimated using the binomial lattice option-pricing model with the following assumptions used for the grants:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Dividend yield range	14.6% - 16.9%	12.6% - 13.1%
Expected volatility range	33.0% - 42.0%	40.0%
Risk-free interest rate range	4.2% - 5.0%	4.3% - 4.6%
Expected term range (in years)	7.4 - 7.5	7.0 - 7.6

The following table presents a summary of the Company's stock option activity for the three months ended March 31, 2007 and 2006:

	<b>Three Months Ended March 31,</b>		<b>Three Months Ended March 31,</b>	
	<b>2007</b>		<b>2006</b>	
	<b>Number</b>		<b>Number</b>	
	<b>of</b>	<b>Weighted</b>	<b>of</b>	<b>Weighted</b>
	<b>Options</b>	<b>Average</b>	<b>Options</b>	<b>Average</b>
		<b>Exercise</b>		<b>Exercise</b>
		<b>Price</b>		<b>Price</b>
Options outstanding - beginning of period	1,576,570	\$ 25.69	1,501,384	\$ 23.09
Granted	415,000	25.91	352,159	27.81
Exercised	(65,154)	12.31	(51,351)	12.68
Canceled			(53,000)	16.18
Options outstanding - end of period	1,926,416	\$ 26.24	1,749,192	\$ 24.52
Options exercisable - end of period	619,670	\$ 22.31	400,693	\$ 12.73

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The intrinsic value of an option is defined as the difference between an option's current market value and the grant price. The intrinsic value of options exercised during the three months ended March 31, 2007 and 2006 was \$0.8 million and \$0.9 million, respectively.

As of March 31, 2007, the intrinsic value and weighted-average remaining life of the Company's options outstanding were \$5.0 million and 8.2 years, respectively.

As of March 31, 2007, the intrinsic value and weighted-average remaining life of the Company's exercisable options outstanding were \$4.0 million and 6.6 years, respectively.

As of March 31, 2007, the total remaining unrecognized compensation expense related to the Company's unvested stock options was \$3.2 million. This unrecognized compensation expense is expected to be recognized over a weighted-average period of 2.2 years.

As of March 31, 2007, the Company has awarded 244,003 shares of restricted Common Stock under the Plan. During the three months ended March 31, 2007 and 2006, the Company recognized compensation expense of \$118 thousand and \$47 thousand, respectively, relating to shares of restricted Common Stock granted under the Plan. As of March 31, 2007, 203,806 shares are vested. In general, unvested restricted stock is forfeited upon the recipient's termination of employment.

**NOTE 18 BANK REGULATORY CAPITAL**

AH Bank is subject to capital adequacy guidelines adopted by the Office of Thrift Supervision (OTS). The most recent notifications received from the OTS categorized AH Bank as well capitalized.

(In thousands) As of March 31, 2007			Minimum For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions	
	Actual					
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	\$ 53,495	78.10%	\$ 5,480	8.00%	\$ 6,850	10.00%
Tier 1 capital (to risk-weighted assets)	\$ 49,821	72.73%	\$ 2,740	4.00%	\$ 4,110	6.00%
Tier 1 capital (average assets)	\$ 49,821	18.49%	\$ 10,775	4.00%	\$ 13,469	5.00%

(In thousands) As of December 31, 2006			Minimum For Capital Adequacy Purposes		Well Capitalized Under Prompt Corrective Action Provisions	
	Actual					
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	\$ 51,847	155.02%	\$ 2,676	8.00%	\$ 3,345	10.00%
Tier 1 capital (to risk-weighted assets)	\$ 48,426	144.79%	\$ 1,338	4.00%	\$ 2,007	6.00%
Tier 1 capital (average assets)	\$ 48,426	57.94%	\$ 3,343	4.00%	\$ 4,179	5.00%

**NOTE 19 COMMITMENTS AND CONTINGENCIES**

**Loans Sold to Investors** In the normal course of business, the Company is obligated to repurchase loans based on violations of representations and warranties, which are subsequently unable to be sold through normal investor channels. At March 31, 2007 and December 31, 2006, the recourse reserve against exposure to repurchased loans was \$18.4 million and \$6.9 million, respectively.

**Table of Contents****NOTE 20 CONCENTRATIONS OF CREDIT RISK**

Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers with similar characteristics, which would cause their ability to meet contractual obligations to be similarly impacted by economic or other conditions. The Company invests in pay option ARM, interest-only ARM, HELOC and certain other types of loans identified as potentially having a concentration of credit risk. The Company, however, generally has purchased supplemental credit insurance for the pay option ARM loans retained in the Company's portfolio if such loans have an initial loan-to-value ratio between 75% and 80%. In addition, the Company generally is the beneficiary of a borrower-paid insurance policy on these types of loans if the initial loan-to-value ratio is greater than 80%.

The following table classifies the Company's mortgage loans held for investment and off-balance sheet securitized loans by product type as of March 31, 2007:

	March 31, 2007 (Dollars in thousands)	
	Loan Balance	Percentage of Total Portfolio
Interest-only	\$ 7,862,697	43.8%
Pay option ARMs	5,858,528	32.7
Second liens	619,377	3.5
Other	3,589,308	20.0
<b>Total</b>	<b>\$ 17,929,910</b>	<b>100.0%</b>

The following table presents the geographic concentrations for the Company's mortgage loans held for investment and off-balance sheet securitized loans as of March 31, 2007:

	March 31, 2007 (Dollars in thousands)	
	Loan Balance	Percentage of Total Portfolio
California	\$ 4,393,863	24.5%
Florida	2,014,843	11.2
Illinois	1,312,894	7.3
Virginia	1,078,109	6.0
New York	893,692	5.0
Other	8,236,509	46.0
<b>Total</b>	<b>\$ 17,929,910</b>	<b>100.0%</b>



**Table of Contents****NOTE 21 ACQUISITIONS****Flower Bank, fsb (now known as American Home Bank)**

On October 19, 2006, the Company, through its wholly-owned subsidiary, American Home Mortgage Holdings, Inc., completed its acquisition of Flower Bank, fsb. In connection with its acquisition, the Company recapitalized Flower Bank through a \$50 million investment in its new subsidiary. Flower Bank subsequently changed its name to American Home Bank on February 1, 2007. AH Bank is expected to hold mortgages, consumer loans and securities as its primary assets, and fund its holdings through deposits including escrow balances.

The following table summarizes the fair value of the assets acquired and liabilities assumed as of the date of the acquisition:

<b>(In thousands)</b>	
Cash and cash equivalents	\$ 2,140
Accounts receivable and servicing advances	677
Securities	3,418
Mortgage loans held for investment, net	25,540
Mortgage servicing rights	343
Premises and equipment	220
Other assets	2,174
 Total assets acquired	 34,512
 Deposits	 30,689
Accrued expenses and other liabilities	5,811
Notes payable	3,000
 Total liabilities assumed	 39,500
 Net liabilities assumed	 (4,988)
 Cash paid	 16,250
 Goodwill	 \$ 21,238

**Waterfield Financial Corporation**

On January 12, 2006, American Home Mortgage Corp. ( AHM ), an indirect, wholly-owned subsidiary of AHM Investment, entered into a Stock and Mortgage Loan Purchase Agreement with Union Federal Bank of Indianapolis ( Union Federal ) and Waterfield Financial Corporation ( WFC ), pursuant to which AHM agreed to purchase from Union Federal 100% of the outstanding capital stock of WFC and certain mortgage loans held by Union Federal, comprised of warehouse loans held for sale by Union Federal as of December 31, 2005 (the Warehouse Loans ), construction loans held by Union Federal as of the closing and certain other loans held by Union Federal as of the closing, for a cash purchase price equal to the net book value of such assets, as modified by certain agreed upon adjustments, as of the respective closing dates (or, in the case of the Warehouse Loans, as of January 12, 2006).

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The following table summarizes the fair value of the assets acquired and liabilities assumed as of the date of the acquisition:

<b>(In thousands)</b>	
Mortgage loans held for sale, net	\$ 559,340
Accounts receivable	2,002
Other assets	2,442
 Total assets acquired	 563,784
 Other liabilities	 13,707
 Total liabilities assumed	 13,707
 Net assets acquired	 550,077
 Cash paid	 550,077
 Goodwill	 \$

**NOTE 22 SEGMENTS AND RELATED INFORMATION**

The Company's segments are Mortgage Holdings, Loan Origination, Loan Servicing and Banking. The Mortgage Holdings segment uses the Company's equity capital and borrowed funds to invest in mortgage-backed securities and mortgage loans held for investment, thereby producing net interest income. The Loan Origination segment originates mortgage loans through the Company's retail and wholesale loan production offices and its correspondent channel, as well as its direct-to-consumer channel supported by its call center. The Loan Servicing segment includes investments in MSR's as well as servicing operations primarily for other financial institutions. The Banking Segment includes loans held for investment, securities and deposits held in AH Bank. The Company's segments are presented on a consolidated basis and do not include the effects of separately recording intercompany transactions.

The Mortgage Holdings segment includes realized gains or losses on sales of mortgage-backed securities and unrealized mark-to-market gains or losses subsequent to the securitization date on mortgage-backed securities classified as trading securities.

The Loan Origination segment includes unrealized gains or losses that exist on the date of securitization of self-originated loans that are classified as trading securities.

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	Three Months Ended March 31, 2007 (In thousands)				
	Mortgage Holdings Segment	Loan Origination Segment	Loan Servicing Segment	Banking Segment	Total
Net interest income:					
Interest income	\$ 219,506	\$ 171,579	\$	\$ 3,192	\$ 394,277
Interest expense	(182,047)	(145,532)	(5,740)	(419)	(333,738)
Net interest income	37,459	26,047	(5,740)	2,773	60,539
Provision for loan losses	(8,965)	(178)			(9,143)
Net interest income after provision for loan losses	28,494	25,869	(5,740)	2,773	51,396
Non-interest income:					
Gain on sales of mortgage loans		126,817			126,817
(Loss) gain on securities and derivatives	(4,245)			3	(4,242)
Loan servicing fees			46,072	12	46,084
Change in fair value of mortgage servicing rights:					
Due to realization of cash flows			(24,940)	(19)	(24,959)
Due to changes in valuation assumptions, net of hedge gain			(1,076)		(1,076)
Net loan servicing fees			20,056	(7)	20,049
Other non-interest income		2,475	717	29	3,221
Total non-interest income	(4,245)	129,292	20,773	25	145,845
Non-interest expenses:					
Salaries, commissions and benefits, net	3,012	98,662	5,797	400	107,871
Occupancy and equipment	2	20,328	874	102	21,306
Data processing and communications	3	5,150	183	41	5,377
Office supplies and expenses		4,631	219	1	4,851
Marketing and promotion	21	4,184	73		4,278
Travel and entertainment	46	7,664	84	3	7,797
Professional fees	1,204	5,668	27	5	6,904
Other	3,845	14,901	2,047	57	20,850
Total non-interest expenses	8,133	161,188	9,304	609	179,234
Net income before income tax (benefit) expense	16,116	(6,027)	5,729	2,189	18,007
Income tax (benefit) expense		(14,851)	1,356	820	(12,675)
Net income	\$ 16,116	\$ 8,824	\$ 4,373	\$ 1,369	\$ 30,682
Dividends on preferred stock	3,305				3,305
Net income available to common stockholders	\$ 12,811	\$ 8,824	\$ 4,373	\$ 1,369	\$ 27,377
March 31, 2007					
Segment assets	\$ 12,728,262	\$ 6,798,671	\$ 736,385	\$ 290,617	\$ 20,553,935

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Three Months Ended March 31, 2006 (In thousands)				
	Mortgage Holdings Segment	Loan Origination Segment	Loan Servicing Segment	Total
Net interest income:				
Interest income	\$ 154,946	\$ 145,667	\$	\$ 300,613
Interest expense	(128,555)	(122,327)	(3,153)	(254,035)
Net interest income	26,391	23,340	(3,153)	46,578
(Provision) recovery of loan losses	(2,507)	1,196		(1,311)
Net interest income after (provision) recovery of loan losses	23,884	24,536	(3,153)	45,267
Non-interest income:				
Gain on sales of mortgage loans		171,907		171,907
Gain on securities and derivatives	8,190	275		8,465
Loan servicing fees			24,333	24,333
Change in fair value of mortgage servicing rights:				
Due to realization of cash flows			(18,735)	(18,735)
Due to changes in valuation assumptions, net of hedge gain			114	114
Net loan servicing fees			5,712	5,712
Other non-interest income		782	987	1,769
Total non-interest income	8,190	172,964	6,699	187,853
Non-interest expenses:				
Salaries, commissions and benefits, net	5,025	90,337	3,905	99,267
Occupancy and equipment	2	17,650	318	17,970
Data processing and communications	16	6,949	161	7,126
Office supplies and expenses		4,278	54	4,332
Marketing and promotion	4	5,791	5	5,800
Travel and entertainment		6,701	52	6,753
Professional fees	1,454	3,877		5,331
Other	2,003	5,016	8,863	15,882
Total non-interest expenses	8,504	140,599	13,358	162,461
Net income before income tax expense (benefit)	23,570	56,901	(9,812)	70,659
Income tax expense (benefit)		19,860	(3,660)	16,200
Net income	\$ 23,570	\$ 37,041	\$ (6,152)	\$ 54,459
Dividends on preferred stock	3,305			3,305
Net income available to common stockholders	\$ 20,265	\$ 37,041	\$ (6,152)	\$ 51,154
March 31, 2006				
Segment assets	\$ 12,935,531	\$ 3,650,025	\$ 491,454	\$ 17,077,010

**NOTE 23 SUBSEQUENT EVENTS**

Subsequent to March 31, 2007, the Company has reduced its net holdings of mortgage-backed securities and securities purchased under agreements to resell by approximately \$655 million to accommodate higher loan balances in part resulting from a carryover of loans in inventory from the previous quarter. A significant portion of these loans have been contractually sold and are awaiting settlement.

On May 4, 2007, the Company issued and sold 4,000,000 shares of Common Stock in an underwritten public offering pursuant to an underwriting agreement, dated April 30, 2007 (the Underwriting Agreement), between the Company and Citigroup Global Markets Inc., as underwriter (the Underwriter). The Company received proceeds of \$92.4 million, before expenses, based on the sales price to the Underwriter of \$23.10 per share. Also, pursuant to the terms of the Underwriting Agreement, the Company granted the Underwriter a 30-day option to purchase up to an additional 600,000 shares of Common Stock to cover over-allotments, if any. The Company intends to use the net proceeds from the offering for general corporate purposes.

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### **ITEM 2.**

#### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

##### **Cautionary Note Regarding Forward-Looking Statements**

This report contains certain forward-looking statements within the meaning of the federal securities laws. Some of the forward-looking statements can be identified by the use of forward-looking words. When used in this report, statements that are not historical in nature, including, but not limited to, the words anticipate, may, estimate, should, seek, expect, plan, believe, intend, and similar words, or the negative words, are intended to identify forward-looking statements. In addition, statements that contain a projection of revenues, earnings (loss), capital expenditures, dividends, capital structure or other financial terms are intended to be forward-looking statements. Certain statements regarding the following particularly are forward-looking in nature:

our business strategy;

future performance, developments, market forecasts or projected dividends;

projected acquisitions or joint ventures; and

projected capital expenditures.

It is important to note that the description of our business in general, and our mortgage-backed securities holdings in particular, is a statement about our operations as of a specific point in time. It is not meant to be construed as an investment policy, and the types of assets we hold, the amount of leverage we use, the liabilities we incur and other characteristics of our assets and liabilities are subject to reevaluation and change without notice.

The forward-looking statements in this report are based on our management's beliefs, assumptions and expectations of our future economic performance, taking into account the information currently available to it. These statements are not statements of historical fact and are not guarantees of future performance, events or results. Forward-looking statements are subject to a number of factors, 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 position. These factors include, without limitation, those factors set forth in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2006, entitled Risk Factors, as well as general economic, political, market, financial or legal conditions and any other factors, risks and uncertainties discussed in filings we make with the Securities and Exchange Commission (SEC).

In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this report might not occur, and we qualify any and all of our forward-looking statements entirely by these cautionary factors. You are cautioned not to place undue reliance on forward-looking statements. Such forward-looking statements are inherently uncertain, and you must recognize that actual results may differ from expectations. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

##### **Critical Accounting Policies and Estimates**

Our accounting policies are described in Note 1 to the Consolidated Financial Statements. We have identified the following accounting policies that are critical to the presentation of our financial statements and that require critical accounting estimates by management.

**Fair Value** - A substantial portion of our assets and certain of our liabilities are carried at fair value. At the beginning of 2007, we adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157), and Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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**Securities, at Fair Value** - The fair values of our securities carried at fair value are generally based on market prices provided by certain dealers who make markets in these financial instruments. Changes in the fair value of securities are recognized in earnings and are included in (loss) gain on securities and derivatives.

**Mortgage Loans Held for Sale** - Mortgage loans held for sale originated prior to January 1, 2007 are carried at the lower of cost or aggregate market value. For such mortgage loans held for sale that are hedged with forward sale commitments, the carrying value is adjusted for the change in market during the time the hedge was deemed to be highly effective. The market value is determined by outstanding commitments from investors or current yield requirements calculated on an aggregate basis.

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***Mortgage Loans Held for Sale, at Fair Value*** - Mortgage loans held for sale originated after January 1, 2007 are carried at fair value. The fair value of mortgage loans held for sale may be determined by either outstanding commitments from investors, recent trade prices for identical or similar loans, or other observable data. Unrealized gain or loss is recognized in earnings for the difference between the cost basis, including upfront costs and fees, and the fair value of the loans. Unrealized gain or loss is included in gain on sales of mortgage loans.

***Mortgage Loans Held for Investment*** - Mortgage loans held for investment are carried at the aggregate of their remaining unpaid principal balances, plus net deferred origination costs, less any related charge-offs and allowance for loan losses. Our periodic evaluation of the adequacy of the allowance for loan losses is based on our past loan loss experience, known and inherent risks in the loan portfolio, adverse circumstances which may affect the borrowers' ability to repay, the estimated value of the underlying real estate collateral and current market conditions within the geographic areas surrounding the underlying real estate. The allowance for loan losses is increased by provision to loan losses charged to income and reduced by charge-offs, net of recoveries.

***Mortgage Servicing Rights (MSRs)*** - When we acquire servicing assets through either purchase or origination of loans and sell or securitize those loans with servicing assets retained, the fair value attributable to the servicing assets is capitalized as MSRs on the consolidated balance sheets. We estimate the fair value of the servicing assets by obtaining market information from one of the market's primary independent MSR brokers.

***Derivative Assets and Derivative Liabilities*** - Our mortgage-committed pipeline includes interest rate lock commitments (IRLCs) that have been extended to borrowers who have applied for loan funding and meet certain defined credit and underwriting criteria and have locked their terms and rates. IRLCs associated with loans expected to be sold are recorded at fair value with changes in fair value recognized in earnings and included in gain on sales of mortgage loans.

We use other derivative instruments, including mortgage forward delivery contracts and treasury futures options, to economically hedge the IRLCs, which are also classified and accounted for as free-standing derivatives and thus are recorded at fair value with the changes in fair value recognized in earnings and included in gain on sales of mortgage loans.

We use mortgage forward delivery contracts designated as fair value hedging instruments to economically hedge 100% of our agency-eligible conforming fixed-rate loans and most of our non-conforming fixed-rate loans held for sale. For loans that we apply hedge accounting to, at the inception of the hedge, we formally document the relationship between the forward delivery contracts and the mortgage inventory, as well as our objective and strategy for undertaking the hedge transactions. In the case of our conventional conforming fixed-rate loan products, the notional amount of the forward delivery contracts, along with the underlying rate and terms of the contracts, are equivalent to the unpaid principal amount of the mortgage inventory being hedged; hence, the forward delivery contracts effectively fix the forward sales price and thereby substantially eliminate interest rate and price risk to us. We classify and account for these forward delivery contracts as fair value hedges. The derivatives are carried at fair value with the changes in fair value recognized in earnings and reported in gain on sales of mortgage loans. When the hedges are deemed to be highly effective, the book value of the hedged loans held for sale is adjusted for its change in fair value during the hedge period.

We enter into interest rate swap agreements to manage our interest rate exposure when financing our mortgage-backed securities and certain ARM loans. Certain swap agreements accounted for as cash flow hedges and certain swap agreements not designated as cash flow hedges are both carried on the balance sheet at fair value. The fair values of our swap agreements are generally based on market prices provided by certain dealers who make markets in these financial instruments or by third-party pricing services.

We use agency trust principal only total return swaps and swaptions to economically hedge our MSRs. Our total return swaps and swaptions are classified and accounted for as free-standing derivatives and thus are recorded at fair value with the changes in fair value recognized in earnings and are included in change in fair value of mortgage servicing rights due to changes in valuation assumptions, net of hedge gain (loss).

***Goodwill*** - Goodwill represents the excess purchase price over the fair value of net assets stemming from business acquisitions, including identifiable intangibles. We test for impairment, at least annually, by comparing the fair value of goodwill, as determined by using a discounted cash flow method, with its carrying value. Any excess of carrying value over the fair value of the goodwill would be recognized as an impairment loss in continuing operations. The discounted cash flow calculation related to our loan origination segment includes a forecast of the expected future loan originations and the related revenues and expenses. The discounted cash flow calculation related to our Mortgage Holdings segment includes a forecast of the expected future net interest income, gain on securities and the related revenues and expenses. These cash flows are discounted using a rate that is estimated to be a weighted-average cost of capital for similar companies.



**Table of Contents****Financial Condition**

The following table presents the Company's consolidated balance sheets as of March 31, 2007 and December 31, 2006:

**AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands)

	March 31, 2007	December 31, 2006
<b>Assets:</b>		
Cash and cash equivalents	\$ 836,860	\$ 398,166
Securities purchased under agreements to resell	58,675	
Accounts receivable and servicing advances	316,673	432,418
Securities	7,557,886	9,308,032
Mortgage loans held for sale, net	955,451	1,523,737
Mortgage loans held for sale, at fair value	3,926,296	
Mortgage loans held for investment, net	6,010,969	6,329,721
Derivative assets	22,718	32,142
Mortgage servicing rights	525,565	506,341
Premises and equipment, net	87,723	86,211
Goodwill	133,248	133,128
Other assets	121,871	79,089
Total assets	\$ 20,553,935	\$ 18,828,985
<b>Liabilities and Stockholders' Equity:</b>		
Liabilities:		
Warehouse lines of credit	\$ 4,013,190	\$ 1,304,541
Commercial paper	1,696,256	1,273,965
Reverse repurchase agreements	6,727,505	8,571,459
Deposits	184,614	24,016
Collateralized debt obligations	4,719,376	4,854,801
Payable for securities purchased	595,277	289,716
Derivative liabilities	36,550	12,644
Trust preferred securities	336,616	336,078
Accrued expenses and other liabilities	396,109	361,923
Notes payable	531,867	417,467
Income taxes payable	92,831	112,089
Total liabilities	19,330,191	17,558,699
Stockholders' Equity:		
Preferred Stock	134,040	134,040
Common Stock	503	502
Additional paid-in capital	965,034	963,617
Retained earnings	173,900	257,283
Accumulated other comprehensive loss	(49,733)	(85,156)
Total stockholders' equity	1,223,744	1,270,286

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Total liabilities and stockholders' equity	\$ 20,553,935	\$ 18,828,985
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Total assets at March 31, 2007 were \$20.55 billion, a \$1.72 billion increase from \$18.83 billion at December 31, 2006. The increase in total assets primarily reflects an increase in mortgage loans held for sale at fair value of \$3.93 billion, partially offset by a decrease in securities of \$1.75 billion, a decrease in mortgage loans held for sale at the lower of cost or market of \$568.3 million and a decrease in loans held for investment of \$318.7 million. At March 31, 2007, 36.8% of our total assets were securities, 29.2% were mortgage loans held for investment, 19.1% were mortgage loans held for sale at fair value and 4.7% were mortgage loans held for sale at the lower of cost or market, compared to 49.4%, 33.6%, 0.0% and 8.1%, respectively, at December 31, 2006.

The following table summarizes our mortgage-backed securities owned at March 31, 2007 and December 31, 2006, classified by type of issuer and by ratings categories:

	March 31, 2007		December 31, 2006	
	Carrying Value	Portfolio Mix	Carrying Value	Portfolio Mix
	(Dollars in thousands)			
Agency securities	\$ 354,935	4.7%	\$ 212,591	2.3%
Privately issued:				
AAA	6,602,927	87.4	8,527,203	91.6
AA	53,585	0.7	54,880	0.6
A	176,484	2.3	170,831	1.8
BBB	147,950	2.0	129,669	1.4
BB	19,104	0.3	4,666	0.1
B	15,794	0.2		
Unrated	182,901	2.4	204,710	2.2
Total mortgage-backed securities	\$ 7,553,680	100.0%	\$ 9,304,550	100.0%

The following tables classify our mortgage-backed securities portfolio by type of interest rate index at March 31, 2007 and December 31, 2006:

	March 31, 2007		December 31, 2006	
	Carrying Value	Portfolio Mix	Carrying Value	Portfolio Mix
	(Dollars in thousands)			
Index:				
One-month LIBOR	\$ 431,172	5.7%	\$ 467,071	5.0%
Six-month LIBOR	3,577,779	47.3	4,463,283	48.0
One-year LIBOR	3,079,631	40.8	3,903,594	42.0
One-year constant maturity treasury	324,310	4.3	335,948	3.6
One-year monthly treasury average	140,788	1.9	134,654	1.4
Total mortgage-backed securities	\$ 7,553,680	100.0%	\$ 9,304,550	100.0%

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The following table classifies our mortgage loans held for investment and mortgage-backed securities portfolio by product type at March 31, 2007 and December 31, 2006:

	March 31, 2007		December 31, 2006	
	Carrying Value	Portfolio Mix	Carrying Value	Portfolio Mix
	(Dollars in thousands)			
Product:				
ARMs less than 3 years	\$ 3,895,623	28.7%	\$ 4,059,711	26.0%
3/1 Hybrid ARM	264,859	1.9	320,737	2.0
5/1 Hybrid ARM	5,928,709	43.7	7,037,879	45.0
7/1 Hybrid ARM	686,194	5.1	1,390,517	8.9
Home equity/Second	188,112	1.4	208,299	1.3
Other ARM	455,007	3.4	482,067	3.1
Fixed rate	2,146,145	15.8	2,135,061	13.7
Total	\$ 13,564,649	100.0%	\$ 15,634,271	100.0%

During the three months ended March 31, 2007, we purchased \$1.5 billion of mortgage-backed securities.

During the three months ended March 31, 2007, we sold \$2.7 billion of mortgage-backed securities.

During the three months ended March 31, 2007, we added \$142.6 million of loans held for investment to our portfolio.

**Table of Contents****Results of Operations**

The following tables present our consolidated and segment statements of income:

**AMERICAN HOME MORTGAGE INVESTMENT CORP. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share amounts)

	March 31,	Dec. 31,	Three Months Ended Sept. 30,	June 30,	March 31,
	2007	2006	2006	2006	2006
Net interest income:					
Interest income	\$ 394,277	\$ 364,810	\$ 332,875	\$ 330,196	\$ 300,613
Interest expense	(333,738)	(322,134)	(289,878)	(279,992)	(254,035)
Net interest income	60,539	42,676	42,997	50,204	46,578
			\$ 2,681.1	\$ 2,864.8	
International			1,167.2	1,420.0	
Hog Production			2,840.2	3,095.3	
Other			252.1	300.0	
Corporate			622.0	531.3	
Assets of discontinued operations held for sale			-	656.5	
Consolidated total assets			\$ 7,562.6	\$ 8,867.9	

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following information in conjunction with the unaudited consolidated condensed financial statements and the related notes in this Quarterly Report and the audited financial statements and the related notes as well as Management's Discussion and Analysis of Financial Condition and Results of Operation contained in our Annual Report on Form 10-K for the fiscal year ended April 27, 2008.

Unless otherwise stated, the amounts presented in the following discussion are based on continuing operations for all fiscal periods included. Certain prior year amounts have changed as a result of including our former beef operations in discontinued operations and to conform to current year presentation.

Our fiscal year consists of either 52 or 53 weeks, ending on the Sunday nearest April 30. The three and nine months ended February 1, 2009 consisted of 14 and 40 weeks, respectively. The three and nine months ended January 27, 2008 consisted of 13 and 39 weeks, respectively.

EXECUTIVE OVERVIEW

We are the leading processor and marketer of fresh pork and packaged meats in the United States, as well as the world's largest producer of hogs. We produce and market a wide variety of fresh meat and packaged meats products both domestically and internationally. We operate in a cyclical industry and our results are significantly affected by fluctuations in commodity prices for hogs, cattle and grains. Some of the factors that we believe are critical to the success of our business are our ability to:

- § maintain and expand market share, particularly in packaged meats,

- § develop and maintain strong customer relationships,

- § continually innovate and differentiate our products,

- § manage risk in volatile commodities markets, and

- § maintain our position as a low cost producer of live hogs, fresh pork and packaged meats.

We conduct our operations through five reporting segments: Pork, International, HP, Other and Corporate. Each segment is comprised of a number of subsidiaries, joint ventures and other investments. The Pork segment consists mainly of our seven wholly-owned U.S. fresh pork and packaged meats subsidiaries. As further described under "Significant Events Affecting Results of Operations – Pork Segment Restructuring" below, we will consolidate these seven subsidiaries into three. The International segment is comprised mainly of our meat processing and distribution operations in Poland, Romania and the United Kingdom, as well as our interests in meat processing operations, mainly in Western Europe, Mexico and China. The HP segment consists of our hog production operations located in the U.S., Poland and Romania as well as our interests in hog production operations in Mexico. The Other segment is comprised of our turkey production operations, our interest in Butterball, our live cattle operations and our interest in live cattle joint venture operations. The Corporate segment provides management and administrative services to support our other segments.

As discussed in further detail under "Results of Operations" below, we announced a plan, in February 2009 (fiscal 2009), to consolidate and streamline the corporate structure and manufacturing operations in our pork group to improve operating efficiencies and increase utilization. The Restructuring Plan will result in the consolidation of



several of our Pork segment business units into three large operating companies. The new business model will allow us to focus on maximizing operating, marketing, financial and logistical synergies that will enable us to better meet the needs of our retail, foodservice and international customers who do business with multiple Smithfield Foods companies.

Our overall focus has shifted from acquisitions to integration, driving operating efficiencies and growing our high margin packaged meats business to fully leverage the benefits of over thirty years of opportunistic acquisitions. The consolidation of our independent operating companies into three strong, market driven companies with strong regional brands and a national presence, will better serve the needs of our customers, employees and other key stakeholders. We expect that the Restructuring Plan will result in annual cost savings and improved pre-tax earnings of approximately \$55.0 million in fiscal 2010 and \$125.0 million by fiscal 2011.

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### Third Quarter of Fiscal 2009 Summary

We incurred a net loss of \$103.1 million, or \$.72 per diluted share, in the third quarter of fiscal 2009, compared to net income of \$54.5 million, or \$.41 per diluted share, in the same quarter last year. The following significant factors impacted our third quarter fiscal 2009 results compared to the third quarter of fiscal 2008:

- § Pork segment operating profit decreased primarily due to the recognition of asset write-downs and other restructuring charges associated with the Restructuring Plan.
- § International segment operating profit decreased primarily due to higher raw material costs, decreased product demand and less favorable results from our equity method investments. We recognized a gain of \$56.0 million on the sale of our interest in Groupe Smithfield to Campofrío, which is not reflected in operating profit.
- § The HP segment experienced a significantly greater operating loss due to significantly higher raising costs.
- § The Other segment incurred an operating loss primarily due to write-downs of cattle inventories resulting from a decline in live cattle market prices.
- § Fiscal 2009 results included a mark to market adjustment on derivative instruments of approximately \$56.0 million, primarily in the HP segment.

### Outlook

The commodity markets affecting our business are extremely volatile and fluctuate on a daily basis. The magnitude of commodity price increases and the subsequent decline over the past nine months is unprecedented. In this erratic and unpredictable operating environment, it is very difficult to make meaningful forecasts of industry trends and conditions. The outlook statements that follow must be viewed in this context.

- § Pork—Throughout fiscal 2008 and thus far in fiscal 2009, the industry experienced record hog slaughter levels. However, in fiscal 2010, sow liquidation in prior periods should result in fewer market hogs. We expect fresh pork prices and live hog values will increase gradually over time as supplies tighten. Fresh pork and packaged meats price increases will depend on the level of customer acceptance of such increases.

While some moderation may occur from fiscal 2008's record export levels, export levels for the remainder of fiscal 2009 and fiscal 2010 are still expected to be well above historical volumes. Domestic hog and meat prices remain a relative value compared to prices in other parts of the world and export demand continues to be strong. These factors should continue to support export sales, at least in the near term. However, some of our competitive advantage may be lost if fresh meat prices rise significantly or the U.S. dollar strengthens.

The restructuring initiatives announced in February 2009 (fiscal 2009) are expected to provide substantial cost savings going forward as we improve operating efficiencies and increase plant utilization.

- § International—Similar to conditions in the U.S., hog producers in Europe and the rest of the world have experienced high grain prices and large losses. They have reacted with herd liquidation. We expect lower slaughter levels will likely result in higher hog prices in Europe and pressure on fresh meat and packaged meats margins. We will attempt to mitigate this margin pressure through price increases, improved productivity and operating performance. We will continue to explore strategic opportunities to maximize the value of our European assets.

§

HP—We have seen a significant decline in market prices for grains over the past several months. As we have explained, we ensured availability of grain supplies last summer through the end of fiscal 2009 by locking in corn at approximately \$6 per bushel through this period. As a result, feed costs will remain at these high levels through the end of fiscal 2009, making the HP segment unprofitable. We believe that raising costs have peaked and will begin to decrease in the first half of calendar 2009. Lower feed prices will increasingly be reflected in cost of sales each month, moving through the first half of fiscal 2010, as hogs consume cheaper feed.

Hog supplies have been at record high levels. Herd reductions should tighten supplies and push prices higher in both the U.S. and Europe, as the oversupply situation corrects itself in the coming months.

§ Other—Near term, we anticipate high grain costs will continue to adversely impact profitability of our turkey operations.

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## RESULTS OF OPERATIONS

## Significant Events Affecting Results of Operations

## Smithfield Beef

In October 2008 (fiscal 2009), we completed the sale of Smithfield Beef, our beef processing and cattle feeding operation, to a wholly-owned subsidiary of JBS for \$575.5 million in cash.

The sale included 100 percent of Five Rivers, which previously was a 50/50 joint venture with CGC. Immediately preceding the closing of the JBS transaction, we acquired CGC's 50 percent investment in Five Rivers for 2,166,667 shares of our common stock valued at \$27.87 per share and \$8.7 million for working capital adjustments.

The JBS transaction excluded substantially all live cattle inventories held by Smithfield Beef and Five Rivers as of the closing date, together with associated debt. The excluded live cattle are currently being raised by JBS for a negotiated fee and sold at maturity at market-based prices. We believe that all but approximately 65,000 of the remaining live cattle inventories will be sold by the end of fiscal 2009, with substantially all sold by the second quarter of fiscal 2010.

The net proceeds from the JBS transaction were used to pay down our U.S. Credit Facility and other long-term debt. As of February 1, 2009, we had received approximately \$42 million in net proceeds from the sale of the retained live cattle inventories, which we used primarily for debt reduction. Based on market prices as of February 1, 2009, we expect to receive an estimated \$90 million of additional net proceeds from the remaining live cattle inventories, which we also plan to use primarily for debt reduction.

We recorded an estimated pre-tax gain of approximately \$95.0 million (\$51.9 million net of tax) on the sale of Smithfield Beef in the second quarter of fiscal 2009. We recorded an additional gain of approximately \$4.5 million (\$2.4 million net of tax) in the third quarter of fiscal 2009 for the settlement of differences in working capital at closing from agreed-upon targets. These gains were recorded in income (loss) from discontinued operations.

The following table presents sales and net income of Smithfield Beef for the fiscal periods indicated:

	Three Months Ended		Nine Months Ended	
	February 1, 2009	January 27, 2008	February 1, 2009	January 27, 2008
	(in millions)		(in millions)	
Sales	\$ -	\$ 670.5	\$ 1,699.0	\$ 2,135.1
Net income	-	1.4	0.9	2.2

## Smithfield Bioenergy, LLC

In May 2008 (fiscal 2009), we completed the sale of substantially all of the assets of SBE for \$11.5 million. During the first quarter of fiscal 2008, we recorded an impairment charge of \$6.7 million, net of tax of \$3.8 million, to write-down the assets to their estimated fair value. We recorded an additional impairment charge of \$2.9 million, net of tax of \$1.6 million, in the third quarter of fiscal 2008. These impairment charges were recorded in income (loss) from discontinued operations.

The following table presents sales and net loss of SBE for the fiscal periods indicated:

Three Months Ended	Nine Months Ended
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	February 1, 2009	January 27, 2008	February 1, 2009	January 27, 2008
	(in millions)		(in millions)	
Sales	\$ -	\$ 4.2	\$ 3.8	\$ 20.0
Net loss	-	(4.5)	(2.7)	(13.3)

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Groupe Smithfield—Campofrío Transaction

In June 2008 (fiscal 2009), we announced an agreement to sell Groupe Smithfield to Campofrío in exchange for shares of Campofrío common stock. In December 2008 (fiscal 2009), the merger of Campofrío and Groupe Smithfield was finalized. The new company, known as Campofrío Food Group, is listed on the Madrid and Barcelona Stock Exchanges. The merger created the largest pan-European company in the packaged meats sector and one of the five largest worldwide.

Immediately prior to the merger, we owned 25% of Campofrío and 50% of Groupe Smithfield. After giving effect to the merger, we currently own 37% of the combined company, which continues to be accounted for under the equity method of accounting.

We determined that the transfer of our interest in Groupe Smithfield to Campofrío met the conditions of a sale in accordance with SFAS 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities – A Replacement of FASB Statement No. 125.” Accordingly, we recorded a pre-tax gain of \$56.0 million on the sale within other income in the third quarter of fiscal 2009.

The amounts presented for Campofrío Food Group throughout this Quarterly Report on Form 10-Q represent the combined results of Groupe Smithfield and Campofrío.

Pork Segment Restructuring

In February 2009 (fiscal 2009), we announced a plan to consolidate and streamline the corporate structure and manufacturing operations of our pork group. This restructuring is intended to make us more competitive by improving operating efficiencies and increasing plant utilization. The plan includes the following primary initiatives:

§ the closing of the following six plants. The production at each of these plants will be transferred to more efficient facilities:

§ Smithfield Packing’s Smithfield South plant in Smithfield, Virginia;

§ Smithfield Packing’s Plant City, Florida plant;

§ Smithfield Packing’s Elon, North Carolina plant;

§ John Morrell’s Great Bend, Kansas plant;

§ Farmland Foods’ New Riegel, Ohio plant; and

§ Armour-Eckrich’s Hastings, Nebraska plant;

§ a reduction in the number of operating companies in the pork group from seven to three;

§ the merger of the fresh pork sales forces of the John Morrell and Farmland Foods business units; and

§ the consolidation of the international sales organizations that are responsible for exports of several of our operating companies into one group.

The new business model will allow us to focus on maximizing operating, marketing, financial and logistical synergies that will enable us to better meet the needs of our retail, foodservice and international customers who do business with multiple Smithfield Foods companies. We expect to achieve a net reduction of approximately 1,800 jobs in the pork group as a result of the restructuring. We expect the initiatives will be substantially completed by the end of the third quarter of fiscal 2010. We believe the Restructuring Plan will result in annual cost savings and improved pre-tax earnings after applicable restructuring expenses of approximately \$55.0 million in fiscal 2010 and \$125.0 million by fiscal 2011.

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As a result of the announced plant closures, we recorded impairment charges of \$72.8 million in the third quarter of fiscal 2009 for the write-down of assets. The charges included \$68.0 million of write-downs of property, plant and equipment to reduce the carrying amounts of the long-lived assets that will be sold or disposed of to their estimated fair values in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The fair values of the plant facilities were determined based on estimated market values obtained from multiple real estate brokers. Additionally, certain inventories, totaling \$4.8 million, were written off as they will be unusable at other operating locations. All of these charges were recorded in cost of sales in the Pork segment.

In addition, we recorded charges totaling \$12.0 million in the Pork segment in the third quarter of fiscal 2009 for employee related benefits. These charges included estimated employee severance benefits, which were accrued in accordance with SFAS 112, "Employers' Accounting for Postemployment Benefits—an amendment of FASB Statements No. 5 and 43," and an estimated obligation for the partial withdrawal from a multiemployer pension plan. Of these charges, \$6.5 million was recorded in cost of sales with the remainder recorded in selling, general and administrative expenses. As of February 1, 2009, none of these amounts had been paid.

We anticipate recording additional charges totaling approximately \$30 million over the remainder of fiscal 2009 and the first half of fiscal 2010 comprised of \$6 million for employee relocation and other benefits, and \$24 million for plant consolidation, asset disposal and plant wind down and mothball expenses. In addition, we estimate that \$53.0 million in capital expenditures will be required relative to plant consolidations in the remainder of fiscal 2009 and in fiscal 2010.

Hedge Accounting

The results of operations for fiscal 2009 reflect our decision to apply hedge accounting to certain commodity derivatives, primarily grain futures, entered into during fiscal 2009. In fiscal 2008, all commodity derivatives were marked to market through earnings. For derivatives that qualify and have been designated as hedges for accounting purposes, changes in fair value have no net impact on earnings, to the extent the derivative is considered perfectly effective in achieving offsetting changes in fair value or cash flows attributable to the risk being hedged, until the hedged item is recognized in earnings.

Classical Swine Fever

In August 2007 (fiscal 2008), outbreaks of CSF occurred at three of our thirty-three hog farms in Romania. During the second quarter of fiscal 2008, we recorded approximately \$13.0 million of inventory write-downs and associated disposal costs related to these outbreaks in the HP segment.

Consolidated Results of OperationsSales and cost of sales

	Three Months Ended				Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change		February 1, 2009	January 27, 2008	% Change
	(in millions)				(in millions)		
Sales	\$ 3,348.2	\$ 3,119.1	7%	\$	9,637.1	\$ 8,482.8	14%
Cost of sales	3,262.1	2,738.4	19		9,119.7	7,534.2	21
Gross profit	86.1	380.7	(77)		517.4	948.6	(45)
Gross profit margin	3%	12%			5%	11%	





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The following items explain the significant changes in sales and gross profit:

Three Months:

§ The increase in sales is primarily due to an additional week of results in fiscal 2009.

§ Higher feed and feed ingredient costs contributed to an increase in domestic raising costs of 27%.

§ Domestic live hog market prices increased 8%.

§ A write-down of assets and other restructuring charges related to the Restructuring Plan increased cost of sales by \$79.3 million.

§ Fiscal 2009 included losses of \$12.6 million on commodity derivative contracts compared to gains of \$76.6 million in fiscal 2008.

Nine Months:

§ Fiscal 2009 included 40 weeks of results compared to 39 weeks in fiscal 2008.

§ Excluding the effects of the additional week of sales, fresh pork volumes increased 8% worldwide due to higher slaughter rates and strong export demand. Including the additional week of sales, pork exports rose 41% in volume and 56% in dollar terms.

§ Higher fresh pork market prices contributed to the increase in sales.

§ Stronger underlying foreign currencies contributed approximately \$108.0 million of sales, or a 1% increase.

§ Higher feed and feed ingredient costs contributed to an increase in domestic raising costs of 26%.

§ Domestic live hog market prices increased 10%.

§ Gains recognized on commodity derivative contracts decreased \$149.5 million.

§ A write-down of assets and other restructuring charges related to the Restructuring Plan increased cost of sales by \$79.3 million.

§ Freight costs increased significantly due to higher fuel prices.

Selling, general and administrative expenses

	Three Months Ended			Nine Months Ended		
	February 1, 2009 (in millions)	January 27, 2008 (in millions)	% Change	February 1, 2009 (in millions)	January 27, 2008 (in millions)	% Change
Selling, general and administrative expenses	\$ 202.2	\$ 237.7	(15) %	\$ 602.5	\$ 619.3	(3) %



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The following items explain the significant changes in selling, general and administrative expenses:

Three Months:

§ Variable compensation expense and fringe costs decreased \$48.8 million due to lower consolidated operating results.

§ Fiscal 2009 included 14 weeks of results compared to 13 weeks in fiscal 2008. We experienced declines in a number of expense categories due to overall efforts to minimize expenses, despite the additional week of results.

§ Foreign currency transaction losses increased \$13.7 million.

§ Losses on company-owned life insurance policies increased approximately \$6.8 million due to declines in the securities markets.

§ Fiscal 2009 included \$5.5 million of estimated severance and other employee related benefits associated with the Restructuring Plan.

Nine Months:

§ Variable compensation expense and fringe costs decreased \$65.1 million due to lower consolidated operating results.

§ Fiscal 2009 includes 40 weeks of results compared to 39 weeks in fiscal 2008. We experienced declines in a number of expense categories due to overall efforts to minimize expenses, despite the additional week of results.

§ Losses on company-owned life insurance policies increased approximately \$13.4 million due to declines in the securities markets.

§ Fiscal 2009 included foreign currency transaction losses of \$6.4 million compared to gains of \$3.3 million in fiscal 2008.

§ Depreciation and amortization increased \$7.1 million driven primarily by farm construction and foreign currency translation.

§ Fiscal 2009 included \$5.5 million of estimated severance and other employee related benefits associated with the Restructuring Plan.

§ We recognized an impairment charge of \$4.3 million in fiscal 2009 related to certain of our investments.

Equity in (income) loss of affiliates

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Butterball	\$ (3.9)	\$ (5.9)	(34) %	\$ 16.6	\$ (25.0)	(166) %

Campofrío Food Group	0.6	(9.6)	(106)	4.2	(19.9)	(121)
Cattleco	10.9	-	NM	10.3	-	NM
Mexican joint ventures	9.1	2.7	(237)	10.3	2.7	(281)
All other equity method investments	0.9	0.5	(80)	0.2	(0.4)	(150)
Equity in (income) loss of affiliates	\$ 17.6	\$ (12.3)	(243)	\$ 41.6	\$ (42.6)	(198)

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The following items explain the significant changes in equity in (income) loss of affiliates:

## Three Months:

- § Campofrío Food Group's results, which include the combined results of Campofrío and Groupe Smithfield, were negatively impacted by higher raw material costs and competitive price pressures, especially at Groupe Smithfield.
- § Cattleco, a 50/50 joint venture with CGC, was formed in conjunction with the JBS transaction to sell the remaining live cattle from Five Rivers that were not sold to JBS. Cattleco's results in fiscal 2009 included a write-down of cattle inventories, our share of which was \$14.5 million, due to a decline in live cattle market prices.
- § Losses on our Mexican hog production investments increased by \$6.9 million, primarily due to an increase in foreign currency transaction losses recognized by our equity method investees.

## Nine Months:

- § Butterball's results were negatively impacted by a significant increase in raw material costs.
- § Campofrío Food Group's results were negatively impacted by higher raw material costs and competitive price pressures, especially at Groupe Smithfield. In addition, Campofrío's results included operating losses and impairment charges related to its discontinued Russian operations, our share of which was \$8.8 million. Also, Groupe Smithfield incurred restructuring and accelerated depreciation charges in fiscal 2009 as a result of its planned closure of one of its cooked meats production facilities. Our share of those charges was \$3.2 million.
- § Cattleco's fiscal 2009 results included a write-down of cattle inventories, our share of which was \$14.5 million, due to a decline in live cattle market prices.
- § Losses on our Mexican hog production investments increased by \$7.7 million, primarily due to an increase in foreign currency transaction losses recognized by our equity method investees.

## Interest expense

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Interest expense	\$ 58.0	\$ 53.2	9 %	\$ 154.6	\$ 142.9	8 %

The increase in interest expense was primarily due to the classification of interest expense related to Smithfield Beef in income (loss) from discontinued operations of approximately \$10 million and \$31 million in the three and nine months ended January 27, 2008, respectively, as well as the effects of an additional week of interest expense in fiscal 2009. These increases were partially offset by lower average outstanding borrowings and significantly lower average rates on our credit facilities. Total debt, including notes payable and capital lease obligations, decreased to \$3,159.2 million as of February 1, 2009 from \$3,883.4 million as of April 27, 2008, primarily due to the use of proceeds from the sale of Smithfield Beef to pay down debt.

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## Other income

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Other income	\$ (63.5)	\$ -	NM	\$ (63.5)	\$ -	NM

Other income, for the three and nine months ended February 1, 2009, included a \$56.0 million gain on the sale of our interest in Groupe Smithfield to Campofrío and a \$7.5 million gain on the repurchase of long-term debt.

## Income tax expense

	Three Months Ended		Nine Months Ended	
	February 1, 2009	January 27, 2008	February 1, 2009	January 27, 2008
Income tax expense (benefit) (in millions)	\$ (24.5)	\$ 43.5	\$ (59.1)	\$ 87.2
Effective tax rate	19%	43%	26%	39%

The variation in the effective tax rate for both the three and nine month periods was mainly due to the recognition of income tax related to the merger of Groupe Smithfield with and into Campofrío in the third quarter of fiscal year 2009. As a result of the merger, we were required to provide additional deferred taxes on the earnings of Groupe Smithfield previously deferred under APB 23, as well as on inherent gains related to the pre-merger holdings of Groupe Smithfield and Campofrío. This expense reduced the income tax benefit, and thus reduced the effective tax rate. The reduction to the effective tax rate for the nine month period was partially offset by the successful resolution of uncertain tax positions during the second quarter of fiscal 2009.

## Segment Results

The following information reflects the results from each respective segment prior to eliminations of inter-segment sales.

## Pork Segment

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Sales	\$ 2,826.6	\$ 2,605.3	8%	\$ 7,995.9	\$ 7,177.0	11%
Operating profit	129.4	221.5	(42)	284.5	310.9	(8)
Sales volume						
Total			6%			8%
Fresh pork			8			13
Packaged meats			4			1
			2%			3%

Average unit selling  
price

Average domestic live hog prices(1)	8	10
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(1) Represents the change in the average live hog market price as quoted by the Iowa-Southern Minnesota hog market.

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In addition to the changes in sales volume, selling prices and live hog prices presented in the table above, the following items explain the significant changes in Pork segment sales and operating profit:

Three Months:

- § The increase in sales and sales volume is primarily due to an additional week of results in fiscal 2009.
- § Operating profit was negatively impacted by restructuring charges totaling \$84.8 million associated with the Restructuring Plan.
- § Operating profit in the prior year benefited from an extremely strong fresh pork market on shipments to East Asia and Russia.
- § Operating profit was negatively impacted by inventory write-downs and other associated costs totaling approximately \$7 million.
- § Fiscal 2008 included a \$4.8 million gain on the sale of Armour-Eckrich's Kansas City, Kansas plant partially offset by a \$1.6 million write-down on the assets of its Lufkin, Texas plant.
- § Operating profit was positively impacted by a \$35.5 million reduction in variable compensation and fringe expenses due to lower consolidated operating results.

Nine Months:

- § The additional week of sales in fiscal 2009 contributed approximately \$200 million of sales, or a 3% increase.
- § Excluding the effect of an additional week of results in fiscal 2009, total sales volume increased 5% with fresh pork volume increasing 11% and packaged meats volume decreasing 2%. Sales volume increased primarily due to very high slaughter rates and strong export demand. Including the additional week of sales in fiscal 2009, pork exports rose 41% in volume and 56% in dollar terms.
- § Operating profit was negatively impacted by restructuring charges totaling \$84.8 million associated with the Restructuring Plan.
- § Operating profit was negatively impacted by a 16% increase in freight costs due to higher fuel prices.
- § Fiscal 2009 included \$11.3 million of union-related litigation and settlement costs.
- § Operating profit was negatively impacted by inventory write-downs and other associated costs totaling approximately \$7 million.
- § Operating profit in the prior year benefited from an extremely strong fresh pork market on shipments to East Asia and Russia.
- § Fiscal 2008 included a \$4.8 million gain on the sale of Armour-Eckrich's Kansas City, Kansas plant partially offset by a \$1.6 million write-down on the assets of its Lufkin, Texas plant.
- § Operating profit was positively impacted by a \$43.6 million reduction in variable compensation and fringe expenses due to lower consolidated operating results.



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## International Segment

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Sales	\$ 333.2	\$ 358.8	(7) %	\$ 1,141.0	\$ 879.7	30%
Operating profit	14.5	22.3	(35)	31.4	46.4	(32)
Sales volume			(25) %			(4) %
Average unit selling price			13%			37%

In addition to the changes in sales volume and selling prices presented in the table above, the following items explain the significant changes in International segment sales and operating profit:

## Three Months:

- § Foreign currency translation decreased sales by approximately \$40.5 million, or 11%, due to a stronger U.S. dollar.
- § Excluding the effect of foreign currency translation, sales and operating profit were positively impacted by a 26% increase in the average unit selling price due to a favorable change in product mix.
- § Equity income decreased \$9.9 million, primarily due to higher raw material costs and competitive price pressures at Campofrío Food Group.
- § Operating profit was negatively impacted by a \$4.3 million increase in foreign currency transaction losses.
- § Operating profit was negatively impacted by significantly higher raw material costs.

## Nine Months:

- § Foreign currency translation increased sales by approximately \$108.0 million, or 12%, due to stronger underlying functional currencies of our foreign subsidiaries during the first six months of fiscal 2009.
- § Excluding the effect of foreign currency translation, sales and operating profit were positively impacted by a 24% increase in the average unit selling price due to a favorable change in product mix.
- § Fiscal 2009 included a full 40 weeks of results from an acquired business in Romania compared to 17 weeks in fiscal 2008, which accounted for approximately \$43.5 million of additional sales, or a 5% increase.
- § Excluding acquisitions, total sales volume decreased 10%.
- § We recorded a loss from our equity method investments of \$1.6 million in fiscal 2009 compared to equity income of \$22.3 million in fiscal 2008. Campofrío Food Group's results were negatively impacted by higher raw material costs and competitive price pressures, especially at Groupe Smithfield. In addition, Campofrío's results included operating losses and impairment charges related to its discontinued Russian operations, our share of which was \$8.8 million. Also, Groupe Smithfield incurred restructuring and accelerated depreciation charges in fiscal 2009 as a result of its planned closure of one of its cooked meats production facilities. Our share of those charges was \$3.2

million.

§ Operating profit was negatively impacted by significantly higher raw material costs.

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## Hog Production Segment

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Sales	\$ 660.5	\$ 558.0	18%	\$ 2,135.1	\$ 1,778.4	20%
Operating profit (loss)	(253.6)	(80.7)	(214)	(350.4)	30.9	NM
Head sold			12%			8%
Average domestic live hog prices(1)			8%			10%
Domestic raising costs			27			26

(1) Represents the change in the average live hog market price as quoted by the Iowa-Southern Minnesota hog market.

In addition to the head sold and other statistical data above, the following items explain the significant changes in HP segment sales and operating profit:

## Three Months:

§ The additional week in fiscal 2009 contributed approximately \$41.0 million of sales, or a 7% increase.

§ Excluding the effect of an additional week of results, total head sold increased approximately 4%.

§ Significantly higher grain costs adversely affected operating profit. Domestic corn and soybean meal costs increased 29% and 22%, respectively. The increase in grain costs is mainly attributable to increased worldwide demand for corn.

§ Fiscal 2009 included losses of \$12.2 million on commodity derivative contracts compared to gains of \$60.7 million in fiscal 2008.

§ The additional week of results in fiscal 2009 negatively impacted operating profit by approximately \$19 million.

§ Losses on our equity method investments increased by \$7.2 million, primarily due to less favorable results from our Mexican joint ventures.

§ Operating profit was negatively impacted by a \$4.9 million increase in foreign currency transaction losses.

## Nine Months:

§ The additional week of sales in fiscal 2009 contributed approximately \$41.0 million of sales, or a 2% increase.

§ Excluding the effect of an additional week of results, total head sold increased approximately 5%.

§

Significantly higher grain costs have adversely affected operating profit. Domestic corn and soybean meal prices increased 41% and 34%, respectively. The increase in grain costs is mainly attributable to increased worldwide demand for corn.

§ Gains recognized on commodity derivative contracts decreased approximately \$137.8 million.

§ The additional week of results in fiscal 2009 negatively impacted operating profit by approximately \$19 million.

§ Losses on our equity method investments increased by \$8.4 million, primarily due to less favorable results from our Mexican joint ventures.

§ Fiscal 2008 included \$13.0 million of inventory write-downs and associated disposal costs related to CSF outbreaks.

§ Fiscal 2009 included foreign currency transaction gains of \$8.6 million compared to losses of \$1.1 million in fiscal 2008.

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## Other Segment

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Sales(2)	\$ 96.0	\$ 38.8	147%	\$ 187.0	\$ 112.3	67%
Operating profit (loss)	(9.5)	7.0	(236)	(28.3)	30.6	(192)

(2)Excludes the sales of Butterball and Cattleco, who are unconsolidated joint ventures accounted for under the equity method.

The following items explain the significant changes in Other segment sales and operating profit:

## Three Months:

§ Fiscal 2009 included \$50.9 million of sales from the liquidation of cattle inventories that were excluded from the JBS transaction.

§ We recorded a loss from our equity method investments of \$7.1 million in fiscal 2009 compared to equity income of \$6.0 million in fiscal 2008. This decline is primarily due to losses incurred at Cattleco, which included a write-down on cattle inventories, our share of which was \$14.5 million, due to a decline in live cattle market prices. Fiscal 2008 did not include any results from Cattleco.

§ Fiscal 2009 operating profit was negatively impacted by a \$4.3 million write-down of company-owned cattle that were excluded from the JBS transaction due to a decline in live cattle market prices.

## Nine Months:

§ Fiscal 2009 included \$53.4 million of sales from the liquidation of cattle inventories that were excluded from the JBS transaction.

§ Sales were positively impacted by a 24% increase in the average unit selling price of our wholly-owned live turkey production operations. The effect of sales growth on operating profit was largely offset by higher feed costs.

§ We recorded a loss from our equity method investments of \$26.9 million in fiscal 2009 compared to equity income of \$25.5 million in fiscal 2008. This decline is primarily due to less favorable results at Butterball due to substantially higher raw material costs and losses incurred at Cattleco. Cattleco's fiscal 2009 results included a write-down on cattle inventories, our share of which was \$14.5 million, due to a decline in live cattle market prices. Fiscal 2008 did not include any results from Cattleco. Additionally, Butterball's results were negatively impacted by a significant increase in raw material costs.

§ Fiscal 2009 operating profit was negatively impacted by a \$4.3 million write-down of company-owned cattle that were excluded from the JBS transaction due to a decline in live cattle market prices.





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## Corporate Segment

	Three Months Ended			Nine Months Ended		
	February 1, 2009	January 27, 2008	% Change	February 1, 2009	January 27, 2008	% Change
	(in millions)			(in millions)		
Operating loss	\$ (16.3)	\$ (16.0)	(2) %	\$ (69.2)	\$ (51.3)	(35) %

The following items explain the significant changes in the Corporate segment's operating loss:

## Three Months:

§ Losses on company life insurance policies increased approximately \$6.8 million due to declines in the securities markets.

§ Foreign currency transaction gains decreased \$3.9 million.

§ Variable compensation and fringe expenses decreased \$9.4 million due to lower consolidated operating results.

## Nine Months:

§ Losses on company-owned life insurance policies increased approximately \$13.4 million due to declines in the securities markets.

§ Fiscal 2009 included foreign currency transaction losses of \$4.0 million compared to gains of \$12.6 million in fiscal 2008.

§ Variable compensation and fringe expenses decreased \$18.4 million due to lower consolidated operating results.

## LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL POSITION

## Summary

Our cash requirements consist primarily of raw materials used in hog production and pork processing operations, long-term debt obligations and related interest, lease payments for real estate, machinery, vehicles and other equipment, and expenditures for capital assets, other investments and other general business purposes. Our primary sources of liquidity are cash we receive as payment for the products we produce and sell, as well as our credit facilities. The meat processing industry is characterized by high sales volume and rapid turnover of inventories and accounts receivable. Because of the rapid turnover rate, we consider our meat inventories and accounts receivable, as well as mature hogs, highly liquid and readily convertible to cash.

The capital markets worldwide, including the U.S., have been severely impacted by credit losses, asset write-downs and failures of some financial institutions. This disruption has impacted credit spreads and pricing on new securities issuances. The recent distress in the financial markets and the global economy in general has not had a significant impact on our operations. However, we continue to monitor the financial markets and general global economic conditions. For a discussion of risks related to the deterioration of the global economy in general, refer to "Item 1A. Risk Factors."



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Based on the following, we believe that our current liquidity position is strong and that our cash flows from operations and availability under our credit facilities will be sufficient to meet our working capital needs and financial obligations for at least the next twelve months:

- § As of February 1, 2009, our liquidity position exceeded \$1 billion, comprised of \$959.7 million of availability on our U.S. Credit Facility, \$90.6 million in cash and cash equivalents and \$29.3 million on international credit lines.
- § We generated \$80.3 million of net cash flows from operating activities for the nine months ended February 1, 2009, despite the net payments of \$79.3 million to our commodities brokers to fund margin requirements primarily related to long grain positions.
- § Future cash flows from operations should benefit from a significant decline in grain prices since the prior year and improved operating efficiencies and plant utilization as a result of the Restructuring Plan.
- § Our focus has shifted from acquisitions and capital spending to integration and debt reduction. Capital expenditures for the nine months ended February 1, 2009 were 55% lower than the prior year. We expect capital expenditures in the near future will be substantially lower than the past several years.

§ If needed, the sale of non-core assets would provide additional capital.

## Cash Flows

The following table summarizes our cash flows from operating, investing and financing activities for the fiscal periods indicated.

	Nine Months Ended	
	February 1, 2009	January 27, 2008
	(Unaudited)	
Net cash flows from:		
Operating activities	\$ 80.3	\$ 121.1
Investing activities	424.8	(373.6)
Financing activities	(488.1)	264.1
Discontinued operations	26.9	(4.5)
Effect of currency exchange rates on cash	(10.6)	(1.0)
Net change in cash and cash equivalents	\$ 33.3	\$ 6.1

## Cash Flows from Operating Activities

Worldwide demand for grains drives our cash requirements both in our domestic and international hog production operations. Recent economic conditions have pressured margins, operating profits and cash from operations. Our swine inventories are turned about 2.5 to 3.0 times per year and the inventory costs are directly related to movements in grain prices. The recent spike in the grain markets to record high price levels has significantly and adversely impacted cash flow in all our swine operations around the world. For example, our domestic raising costs for the first nine months of fiscal 2009 were \$62 per hundredweight compared to \$49 per hundredweight for the first nine months of fiscal 2008. We believe these increases, at least in part, can be traced directly back to the United States' 'corn to ethanol' policy. While no one can determine precisely the exact impact of this policy, we think that the impact on corn prices has been substantial and will continue to influence cash requirements in our hog production operations. As

noted below, these circumstances affected us in fiscal 2008, but even more dramatically in fiscal 2009.

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While grain prices reached record high levels in fiscal 2009, we have seen a sharp decline over the past several months. We expect that cash requirements for grain purchases will be substantially lower in fiscal 2010.

The following items explain the significant changes in cash flows from operating activities:

§ Cash paid for grains and fuel increased substantially as a result of higher commodity prices.

§ Cash received from customers increased as a result of higher sale volumes and selling prices.

§ Cash paid for the settlement of derivative contracts and for margin requirements was \$79.3 million in fiscal 2009 compared to cash received of \$183.4 million in fiscal 2008.

### Cash Flows from Investing Activities

The following items explain the significant sources and uses of cash from investing activities for the nine months ended February 1, 2009 and January 27, 2008:

Fiscal 2009:

- We received \$575.5 million from the sale of Smithfield Beef.
- Capital expenditures totaled \$154.4 million, primarily related to plant and hog farm improvement projects.

Fiscal 2008:

- Capital expenditures totaled \$344.0 million, primarily related to packaged meats expansion, plant improvement projects and additional hog production facilities.
- We used \$40.0 million for the acquisition of PSF.

### Cash Flows from Financing Activities

The following items explain the significant sources and uses of cash from financing activities for the nine months ended February 1, 2009 and January 27, 2008:

Fiscal 2009:

- § We had net repayments of \$754.0 million on our long-term credit facilities.
- § We received net proceeds of \$337.5 million from the issuance of the Convertible Notes and the Call Spread Transactions (see further discussion under “Fiscal 2009 Activities—Convertible Notes and Call Spread Transactions”).
- § We borrowed \$200.0 million under a three-year term loan with Rabobank.
- § Principle payments on long-term debt and capital lease obligations were \$169.4 million.
- § We received \$122.2 million from the issuance of common stock (see further discussion under “Fiscal 2009 Activities—COFCO Share Issuance”).

§ We had net repayments on notes payable of \$138.3 million.

§ We repurchased short-term debt for \$86.2 million.

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### Fiscal 2008:

§ In June 2007 (fiscal 2008), we issued \$500.0 million of 7.75% senior unsecured notes that mature in 2017. We used the proceeds from this issuance to repay existing indebtedness, principally on our U.S. Credit Facility.

§ We had net repayments of \$18.0 million on our long-term credit facilities and notes payable.

§ We had net repayments on long-term debt totaling \$213.2, including \$188.7 million on certain long-term debt instruments that matured during the first quarter of fiscal 2008.

### Fiscal 2009 Activities

As noted above, our recent cash requirements have been substantial. We have taken a number of steps to assure ourselves that we will have needed liquidity for the remainder of fiscal 2009 and fiscal 2010.

### Credit Facilities

In May 2008 (fiscal 2009), we obtained an uncommitted secured credit line for \$150.0 million from Citibank, N.A. and borrowed \$100.0 million under it. In July 2008 (fiscal 2009), we repaid the \$100.0 million and terminated the credit line. The proceeds of the borrowing and the repayment were applied to and drawn from the U.S. Credit Facility.

In June 2008 (fiscal 2009), we exercised our option to increase the amount committed under the U.S. Credit Facility by \$25.0 million, resulting in \$1.3 billion of available borrowings under the U.S. Credit Facility.

In addition, in June 2008 (fiscal 2009), we entered into a \$200.0 million unsecured committed credit facility with JP Morgan Chase Bank and Goldman Sachs Credit Partners L.P., intended to help bridge our working capital needs through the time of the closing of the sale of Smithfield Beef in the event we were unable to issue the Convertible Notes described below. This credit facility replaced an existing and fully drawn \$50.0 million line. We repaid the \$50.0 million in June 2008 (fiscal 2009) and terminated this credit facility in July 2008 (fiscal 2009).

As of February 1, 2009, we had aggregate credit facilities and credit lines, including uncommitted credit lines, totaling \$1,775.1 million including unused capacity of \$989.0 million, of which \$959.7 million represents unused capacity under the U.S. Credit Facility. There was no available capacity under our Euro Credit Facility.

### Term Loan

In August 2008 (fiscal 2009), we entered into a three-year \$200.0 million term loan with Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. (Rabobank) maturing on August 29, 2011. The term loan had an initial interest rate of 6.3% and has since been adjusted to 7.83% to correlate to the recent increase in interest rate spreads under the U.S. Credit Facility. The term loan replaced \$150.0 million of short-term uncommitted facilities which were available and borrowed from Rabobank.

### Smithfield Beef

As discussed in greater detail earlier under “Significant Events Affecting Results of Operations—Discontinued Operations,” we received \$575.5 million in cash in connection with the sale of Smithfield Beef, which was used to pay down our U.S. Credit Facility and other long-term debt. In addition, as of February 1, 2009, we had received approximately \$42 million in net proceeds from the sale of the retained live cattle inventories, which we used primarily for debt reduction. Based on current market prices, we expect to receive an estimated \$90 million of

additional net proceeds from the remaining live cattle inventories, which we also plan to use primarily for debt reduction.

We believe that all but approximately 65,000 of the remaining live cattle inventories will be sold by the end of fiscal 2009, with substantially all sold by the second quarter of fiscal 2010. We expect to use the net proceeds from the sale of the retained live cattle inventories primarily for debt reduction.

#### Convertible Notes and Call Spread Transactions

In July 2008, we issued \$400.0 million aggregate principal amount of 4% convertible senior notes due June 30, 2013 in a registered offering. The Convertible Notes are payable with cash and, at certain times, are convertible into shares of our common stock based on an initial conversion rate, subject to adjustment, of 44.082 shares per \$1,000 principal amount of Convertible Notes (which represents an initial conversion price of approximately \$22.68 per share). Upon conversion, a holder will receive cash up to the principal amount of the Convertible Notes and shares of our common stock for the remainder, if any, of the conversion obligation.



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In connection with the issuance of the Convertible Notes, we entered into separate convertible note hedge transactions with respect to our common stock to minimize the impact of potential economic dilution upon conversion of the Convertible Notes, and separate warrant transactions.

We purchased call options in private transactions that permit us to acquire up to approximately 17.6 million shares of our common stock at an initial strike price of \$22.68 per share, subject to adjustment, for \$88.2 million. We also sold warrants in private transactions for total proceeds of approximately \$36.7 million. The warrants permit the purchasers to acquire up to approximately 17.6 million shares of our common stock at an initial exercise price of \$30.54 per share, subject to adjustment.

The Call Spread Transactions, in effect, increase the initial conversion price of the Convertible Notes from \$22.68 per share to \$30.54 per share, thus reducing the potential future economic dilution associated with conversion of the notes. The Convertible Notes and the warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock during a given measurement period exceeds the respective exercise prices of those instruments. The call options are excluded from the calculation of diluted earnings per share as their impact is always anti-dilutive.

The net proceeds of approximately \$337.5 million from the issuance of the Convertible Notes and the Call Spread Transactions were used to retire short-term uncommitted credit lines and to reduce amounts outstanding under the U.S. Credit Facility.

## COFCO Share Issuance

In July 2008 (fiscal 2009), we issued a total of 7,000,000 shares of our common stock to Starbase International Limited, a company registered in the British Virgin Islands which is a subsidiary of COFCO (Hong Kong) Limited (COFCO). The shares were issued at a purchase price of \$17.45 per share. The proceeds from the issuance of these shares were used to reduce amounts outstanding under the U.S. Credit Facility.

COFCO's investment in the Company is passive in nature and the purchase agreement contains standstill provisions. The purchase agreement also contains restrictions on sales or other transfers of the shares by COFCO until July 9, 2009.

## Credit Ratings

In June 2008 (fiscal 2009), Standard & Poor's Rating Services (S&P) downgraded our 'BB+' credit rating to 'BB-'. Based on amounts outstanding as of February 1, 2009, the annual pretax impact to earnings of this downgrade by S&P can be expected to be \$1.8 million, all of which will be related to increased interest expense. In December 2008 (fiscal 2009), S&P further downgraded our 'BB-' credit rating to 'B.' This downgrade did not impact the interest rates on our variable debt.

In October 2008 (fiscal 2009), Moody's Investor Services (Moody's) downgraded our 'Ba2' credit rating to 'B1'. Based on amounts outstanding as of February 1, 2009, the annual pretax impact to earnings of this downgrade by Moody's can be expected to be \$0.6 million, all of which will be related to increased interest expense.

A further downgrade by either S&P or Moody's would increase the interest rate on the Euro Credit Facility by 0.25%. Based on amounts outstanding as of February 1, 2009, the annual pre-tax impact to earnings from a one level downgrade by either S&P or Moody's would be \$1.0 million, and a downgrade by both rating agencies would be \$1.9 million.

## Debt Covenants

Our various debt agreements contain financial covenants that require the maintenance of certain levels of ratios for working capital, net worth, fixed charges, leverage, interest coverage and capital expenditures. These financial covenants limit additional borrowings, the acquisition, disposition and leasing of assets and payments of dividends to shareholders, among other restrictions.

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Our senior unsecured notes preclude us from incurring certain additional indebtedness when our interest coverage ratio is less than 2.0 to 1.0 (the Incurrence Test). The ratio is calculated differently from similar ratios under the U.S. Credit Facility and Euro Credit Facility. As of February 1, 2009, we did not meet the Incurrence Test. Due to the trailing twelve month nature of the Incurrence Test, we do not expect to meet the Incurrence Test again until the third quarter of fiscal 2010. The Incurrence Test is not a covenant and our failure to meet the Incurrence Test is not a default. In addition to precluding us from incurring certain additional indebtedness, our failure to meet the Incurrence Test restricts us from engaging in certain other activities, including paying cash dividends, repurchasing our common stock and making certain investments. However, our failure to meet the Incurrence Test does not preclude us from refinancing or increasing our borrowings under the U.S. Credit Facility or the Euro Credit Facility, or from refinancing certain other existing indebtedness, including our senior unsecured notes maturing in October 2009 (\$206.3 million outstanding as of February 1, 2009) and our senior secured notes also maturing in October 2009 (\$37.5 million outstanding as of February 1, 2009). Therefore we do not expect the limitations resulting from our failure to meet the Incurrence Test to have a material adverse effect on our business. We have no current plans, during the period in which we do not expect to meet the Incurrence Test, to incur indebtedness beyond that which we are permitted to incur, nor to engage in any of the other restricted activities.

During the first quarter of fiscal 2009, we amended the interest coverage ratio minimum from 3.0 to 1 to 2.0 to 1 until the end of fiscal 2009 under the U.S. Credit Facility and the Euro Credit Facility.

In February 2009 (fiscal 2009), we further amended the interest coverage ratio under the U.S. Credit Facility and the Euro Credit Facility such that the interest coverage ratio will be as follows: 1.6 to 1 for the third quarter of fiscal 2009; 1.2 to 1 for the fourth quarter of fiscal 2009; 1.35 to 1 for the first and second quarters of fiscal 2010; and 2.0 to 1 for the third quarter of fiscal 2010. Pursuant to the original terms of the U.S. Credit Facility and the Euro Credit Facility, the ratio will return to 3.0 to 1 for the fourth quarter of fiscal 2010 and thereafter.

In addition to the amended interest coverage ratio, the amendment entered into in February 2009 (fiscal 2009) for the U.S. Credit Facility included the following provisions:

- § A revision of the inventory and receivables ratio coverage covenant to require a ratio of (i) the sum of 65% of the aggregate amount of inventory plus 85% of the aggregate amount of accounts receivable to (ii) the revolving credit exposure under the U.S. Credit Facility and any pari passu debt, to be at or above 1.3 to 1;
- § An increase in the applicable borrowing spreads for loans and letters of credit from a rating-based grid of 1.125% to a flat 3.50%. Commitment fees were also increased from .20% to .50%;
- § An elimination of the ability to borrow based on the offered rate for overnight federal funds; and
- § An agreement by us to execute and deliver to the administrative agent, within thirty days of February 2, 2009, a deed of trust (in form and substance reasonably satisfactory to the administrative agent) with respect to the real property of one of our subsidiaries, Smithfield Packing, (including buildings and improvements) located in Bladen County, North Carolina known as Smithfield Packing's Tar Heel pork processing plant. This deed of trust was delivered within the required thirty days from February 2, 2009.

In addition to the amended interest coverage ratio, the amendment entered into in February 2009 (fiscal 2009) for the Euro Credit Facility included the following provisions:

- § A revision of the asset coverage ratio to require a ratio of certain of our assets to the aggregate outstanding loans under the Euro Credit Facility to be at or above 1.75 to 1;

§ The pledge of additional shares of Campofrío not previously securing the Euro Credit Facility;

§ The pledge of certain accounts receivable and inventory of certain of our Romanian and Polish subsidiaries;

§ An increase in the applicable borrowing spreads for loans from a rating-based grid of 1.225% to a rating-based grid of 4.00%. Commitment fees were also increased from .6125% to .75%;

§ A borrowing base that will limit borrowings as a function of the assigned values of the pledged Campofrío shares and accounts receivable and inventory of certain of our Romanian and Polish subsidiaries.

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As a result of the amendments to the U.S. Credit Facility and Euro Credit Facility in February 2009 (fiscal 2009), we expect annual interest expense to increase by approximately \$20 million to \$25 million. We incurred fees and expenses associated with the two amendments totaling approximately \$12.0 million, which were capitalized and will be amortized to interest expense over the remaining term of these facilities.

For our senior secured notes totaling \$37.5 million outstanding as of February 1, 2009, we have received amendments of certain covenants. As of February 1, 2009, we were in compliance with all financial covenants under our senior secured notes, the U.S. Credit Facility and the Euro Credit Facility.

### Guarantees

As part of our business, we are party to various financial guarantees and other commitments as described below. These arrangements involve elements of performance and credit risk that are not included in the consolidated balance sheet. We could become liable in connection with these obligations depending on the performance of the guaranteed party or the occurrence of future events that we are unable to predict. If we consider it probable that we will become responsible for an obligation, we will record the liability in our consolidated balance sheet.

We (together with our joint venture partners) guarantee financial obligations of certain unconsolidated joint ventures. The financial obligations are: up to \$92.0 million of debt borrowed by Agroindustrial del Noroeste (Norson), of which \$71.0 million was outstanding as of February 1, 2009, and up to \$3.5 million of liabilities with respect to currency swaps executed by another of our unconsolidated Mexican joint ventures, Granjas Carroll de Mexico (Granjas). The covenants in the guarantee relating to Norson's debt incorporate our covenants under the U.S. Credit Facility. In addition, we continue to guarantee \$19.4 million of leases that were transferred to JBS in connection with the sale of Smithfield Beef. Some of these lease guarantees will be released in the near future and others will remain in place until the leases expire.

### Additional Matters Affecting Liquidity

#### Capital Projects

As part of the Restructuring Plan, we estimate that the plant consolidations will require \$53.0 million in capital expenditures will be required relative to plant consolidations in the remainder of fiscal 2009 and in fiscal 2010. As of February 1, 2009, we had total estimated remaining capital expenditures of \$81.0 million on approved projects. These projects are expected to be funded over the next several years with cash flows from operations and borrowings under credit facilities. Total capital expenditures are expected to remain below depreciation in fiscal 2009 and 2010.

#### Group Pens

In January 2007 (fiscal 2007), we announced that we were in the beginning stages of phasing out individual gestation stalls at our sow farms and replacing the gestation stalls with group pens. We anticipate this will occur over the next 10 to 13 years. We currently estimate the total cost of our transition to group pens to be approximately \$300.0 million. We believe this decision represents a significant financial commitment and was made as a result of the desire to be more animal friendly, as well as to address certain concerns and needs of our customers. We do not expect that the switch to penning systems at sow farms will have a material adverse effect on our operations. As a result of current economic conditions in hog production, this project is being implemented as cash flow permits.

#### Risk Management Activities

We are exposed to market risks primarily from changes in commodity prices, and to a lesser degree, interest rates and foreign exchange rates. To mitigate these risks, we utilize derivative instruments to hedge our exposure to changing prices and rates, as more fully described under Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—"Derivative Financial Instruments" in our Annual Report on Form 10-K for the fiscal year ended April 27, 2008. Our liquidity position may be positively or negatively affected by changes in the underlying value of our derivative portfolio. When the value of our open derivative contracts decreases, we may be required to post margin deposits with our brokers to cover a portion of the decrease. Conversely, when the value of our open derivative contracts increases, our brokers may be required to deliver margin deposits to us for a portion of the increase. During the first nine months of fiscal 2009, margin deposits posted by us ranged from \$7.0 million to \$272.3 million. The average daily amount on deposit with brokers during the first nine months of fiscal 2009 was \$111.0 million. As of February 1, 2009, the net amount on deposit with brokers was \$85.7 million.

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The effects, positive or negative, on liquidity resulting from our risk management activities tend to be mitigated by offsetting changes in cash prices in our core business. For example, in a period of rising grain prices, gains resulting from long grain derivative positions would generally be offset by higher cash prices paid to farmers and other suppliers in spot markets. These offsetting changes do not always occur, however, in the same amounts or in the same period, with lag times of as much as twelve months.

### Pension Plan Funding

We have contributed \$47.4 million to our pension plans in fiscal 2009. We expect to contribute at least \$10.5 million to our pension plans in the fourth quarter of fiscal 2009. Due to the recent economic downturn and related declines in the market value of our pension plan assets, our funding requirements in fiscal 2010 may increase significantly. See “Critical Accounting Policies and Estimates” for further discussion.

### Litigation Costs

PSF, certain of our other subsidiaries and affiliates and us are parties to litigation in Missouri involving a number of claims alleging that hog farms owned or under contract with the defendants interfered with the plaintiffs’ use and enjoyment of their properties. These claims are more fully described in “Item 3. Legal Proceedings—Missouri Litigation,” in our Annual Report on Form 10-K for the fiscal year ended April 27, 2008, “Item 1. Legal Proceedings—Missouri litigation” in our Quarterly Report on Form 10-Q for the quarterly periods ended July 27, 2008 and October 27, 2008, and “Item 1. Legal Proceedings—Missouri litigation” herein. We established a reserve estimating our liability for these and similar potential claims on the opening balance sheet for our acquisition of PSF. Consequently, expenses and other liabilities associated with these claims will not affect our profits or losses unless our reserve proves to be insufficient or excessive. However, legal expenses incurred in defense of these claims and any payments made to plaintiffs through unfavorable verdicts or otherwise will negatively impact our cash flows and our liquidity position. Although we recognize the uncertainties of litigation, based on our historical experience and our understanding of the facts and circumstances underlying these claims, we believe that these claims will not have a material adverse effect on our results of operations or financial condition.

### Financial Position

Our balance sheet as of February 1, 2009, as compared to April 27, 2008, was impacted by the following significant changes:

- § Assets and liabilities of discontinued operations held for sale decreased \$656.5 million and \$138.4 million, respectively, due to the sale of Smithfield Beef and SBE.
- § Net property, plant and equipment decreased \$358.8 million mainly due to (i) additional depreciation of \$202.5 million; (ii) the effects of foreign currency translation of \$209.5 million; and (iii) asset write-downs of \$69.4 million, primarily related to the Restructuring Plan; partially offset by (iv) \$154.4 million of capital expenditures.
- § Total debt, including notes payable, decreased \$724.2 million mainly due to (i) net repayments on long-term credit facilities and notes payable of \$892.3 million; (ii) principal payments on long-term debt and capital leases of \$169.4 million; (iii) the effects of foreign currency translation of approximately \$174.0 million; and (iv) short-term debt repurchases of \$86.2 million; partially offset by new borrowings of \$600.0 million.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of consolidated condensed financial statements requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions are based on our experience and our understanding of the current facts and circumstances. Actual results could differ from those estimates.

The following describes updates to our critical accounting policies and estimates, which are more fully described in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended April 27, 2008.



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### Pension Accounting

Our pension plan funding requirements and reported costs are dependent on a variety of assumptions regarding future events, including discount rates used to measure our pension obligation and net periodic benefit cost, and expected returns on plan assets. The recent deterioration in the securities markets has had a significant negative impact on the value of plan assets, the effect of which has not been reflected in the consolidated condensed financial statements as of and for the nine months ended February 1, 2009 pursuant to the provisions of SFAS No. 158, which require plan assets and obligations to be re-measured at the end of fiscal 2009. Upon re-measurement, if the fair value of plan assets does not recover or declines further, or market conditions at that time necessitate adverse changes in certain actuarial assumptions (such as the discount rates or the expected rate of return on plan assets), we would experience an adverse change in the funded status of our plans which would lead to additional cash contribution requirements and increased net benefit cost for fiscal 2010 as compared to fiscal 2009.

### Impairment of Goodwill

Our policy is to perform an annual test of goodwill for impairment in the fourth quarter of each year. As a result of significant losses recently incurred in our hog production operations, the deteriorating macro-economic environment, the continued market volatility and the decrease in our market capitalization, we performed an interim test of the carrying amount of goodwill related to our U.S. hog production operations as required by SFAS No. 142 "Goodwill and Other Intangible Assets" (SFAS 142).

In accordance with SFAS 142, goodwill impairment is determined using a two-step process. The first step is to identify if a potential impairment exists by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to have a potential impairment and the second step of the impairment test is not necessary. However, if the carrying amount of a reporting unit exceeds its fair value, the second step is performed to determine if goodwill is impaired and to measure the amount of impairment loss to recognize, if any.

The second step compares the implied fair value of goodwill with the carrying amount of goodwill. If the implied fair value of goodwill exceeds the carrying amount, goodwill is not considered impaired. However, if the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination (i.e., the fair value of the reporting unit is allocated to all the assets and liabilities, including any unrecognized intangible assets, as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit).

We estimate the fair value of our reporting units by applying valuation multiples or estimating future discounted cash flows. The selection of multiples is dependent upon assumptions regarding future levels of operating performance as well as business trends, prospects and market and economic conditions. A discounted cash flow analysis requires us to make various judgmental assumptions about sales, operating margins, growth rates and discount rates. When estimating future discounted cash flows, we consider the assumptions that hypothetical marketplace participants would use in estimating future cash flows. In addition, where applicable, an appropriate discount rate is used, based on our cost of capital or location-specific economic factors.

As of February 1, 2009, the carrying amount of goodwill related to our U.S. hog production operations was \$451.7 million. We determined that the fair value of our U.S. hog production reporting unit exceeded its carrying value. Therefore, goodwill was not impaired. While we believe we have made reasonable estimates and assumptions to calculate the fair value of this reporting unit, it is possible a material change could occur. If the actual results are not consistent with our estimates and assumptions used to calculate the fair value of this reporting unit, a material

impairment of our goodwill could result.

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FORWARD-LOOKING STATEMENTS

This report contains “forward-looking” statements within the meaning of the federal securities laws. The forward-looking statements include statements concerning our outlook for the future, as well as other statements of beliefs, future plans and strategies or anticipated events, and similar expressions concerning matters that are not historical facts. Our forward-looking information and statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, the statements. These risks and uncertainties include the availability and prices of live hogs and cattle, raw materials, fuel and supplies, food safety, livestock disease, live hog production costs, product pricing, the competitive environment and related market conditions, hedging risk, operating efficiencies, changes in interest rate and foreign currency exchange rates, changes in our credit rating, access to capital, the investment performance of our pension plan assets and the availability of legislative funding relief, the cost of compliance with environmental and health standards, adverse results from on-going litigation, actions of domestic and foreign governments, labor relations issues, credit exposure to large customers, the ability to make effective acquisitions and dispositions and successfully integrate newly acquired businesses into existing operations and other risks and uncertainties described in Item 1A “Risk Factors” in our Annual Report on Form 10-K for fiscal 2008 and in this Quarterly Report on Form 10-Q for the period ended February 1, 2009. Readers are cautioned not to place undue reliance on forward-looking statements because actual results may differ materially from those expressed in, or implied by, the statements. Any forward-looking statement that we make speaks only as of the date of such statement, and we undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. Comparisons of results for current and any prior periods are not intended to express any future trends or indications of future performance, unless expressed as such, and should only be viewed as historical data.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For complete quantitative and qualitative disclosures about market risk affecting the Company, see Item 7A “Qualitative and Quantitative Disclosures About Market Risk” of our Annual Report on Form 10-K for the fiscal year ended April 27, 2008. Our exposure to market risk from commodities is detailed below.

The following table presents the sensitivity of the fair value of our open commodity contracts and interest rate and foreign currency contracts to a hypothetical 10% change in market prices or in interest rates and foreign exchange rates, as of February 1, 2009 and April 27, 2008.

	February 1, 2009	April 27, 2008
	(in millions)	
Livestock	\$ 23.2	\$ 160.7
Grains	30.0	24.7
Energy	2.2	2.9
Interest rates	1.2	2.0
Foreign currency	7.7	1.3

## ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), regarding the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of February 1, 2009. Based on that evaluation, management, including the CEO and CFO, has concluded that our disclosure controls and procedures were effective as of February 1, 2009.

There were no changes in our internal control over financial reporting during our third quarter of fiscal 2009 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Missouri litigation

As previously disclosed in our Annual Report on Form 10-K filed on June 26, 2008 and our Quarterly Reports on Forms 10-Q filed on September 5, 2008 and December 5, 2008, lawsuits based on the law of nuisance were filed against PSF and CGC in the Circuit Court of Jackson County, Missouri entitled Steven Adwell, et al. v. PSF, et al. and Michael Adwell, et al. v. PSF, et al. By order dated July 8, 2008, the court consolidated the claims of the remaining 49 Adwell plaintiffs for trial by farm. By order dated February 6, 2009, the court denied plaintiffs' motion to consolidate the claims of the six Adwell plaintiffs who live near one farm for trial with those of the four plaintiffs in Doyle Bounds, et al. v. PSF, et al. The court also ordered that the Adwell plaintiffs living around each of the three farms at issue will be further divided into two groups based on the time periods covered by their claims. As a result, there may be as many as six additional trials in the Adwell cases, two for each farm. However, the court left open the possibility for reconsolidation on a farm-by-farm basis in the future. The court also scheduled the next Adwell trial, which will resolve the claims of 13 plaintiffs who live near Homan farm whose claims begin in 1999, to commence on February 1, 2010.

We believe we have good defenses to all of the actions described above and intend to defend vigorously these suits.

Souderton facility

As previously disclosed in our Annual Report on Form 10-K filed on June 26, 2008 and our Quarterly Report on Form 10-Q filed on December 5, 2008, our former Souderton facility, which is now owned by JBS Souderton, Inc., a wholly-owned subsidiary of JBS Packerland, Inc. (collectively JBS Packerland), has experienced wastewater releases and an operational upset. The investigations into these incidents by the Environmental Protection Agency (the EPA), the Pennsylvania Department of Environmental Protection (PADEP) and the Pennsylvania Fish and Boat Commission are still on-going.

The Souderton facility was a part of our sale of Smithfield Beef to JBS Packerland which was completed in October 2008 (fiscal 2009). Under the terms of the sale, we have indemnification obligations for specified losses related to these pre-closing wastewater releases and operational upsets at the Souderton facility. However, JBS Packerland has assumed all remaining capital costs associated with the planned wastewater treatment system upgrade to which we agreed with PADEP after the two wastewater incidents in 2006. At this time, we do not believe that these indemnification obligations will have a material adverse effect on our financial position or results of operations.

On November 21, 2008, PADEP issued a unilateral administrative order requiring development and implementation of a plan for certain corrective action activities relative to the prior rendering plant release, including, but not limited to, examination of pipes leading from the rendering facility, replacement of compromised piping, if any, construction of a new intercept sewer from rendering to the facility's wastewater treatment plant, and the submission of a written report describing actions taken to comply with the administrative order. These requirements are consistent with activities we, the EPA and PADEP have previously concurred are appropriate in terms of preventing further occurrences and on which the parties had already been working. PADEP did not order the payment of any fine or penalties in this order.

The EPA filed a lawsuit in the United States District Court for the Eastern District of Pennsylvania against JBS Packerland on December 29, 2008 relative to the prior releases. This maintains EPA's jurisdiction over the process and barred the threatened filing of a citizen suit by a local citizens group. The EPA, PADEP and JBS Packerland filed

a joint motion to extend the answer deadline in order to allow time to continue and complete settlement discussions and the court granted the motion.

#### Farmland Crete Facility

On December 5, 2008, EPA Region 7 issued a Notice of Violation (the NOV) to Farmland relative to Farmland's facility in Crete, Nebraska. The NOV alleges that the Crete facility exceeded opacity limitations, testing and recordkeeping requirements specified in an air permit issued to the Crete facility by the Nebraska Department of Environmental Quality. After an internal investigation by outside counsel, counsel and representatives of the Company held an informal conference with EPA, and settlement discussions are ongoing. While we could face potential monetary penalties, management believes that any ultimate liability with respect to these matters would not have a material adverse effect on our financial position or operations.

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ITEM 1A.

RISK FACTORS

In addition to the following risk factor, our Annual Report on Form 10-K for fiscal 2008 includes a listing of risk factors to be considered by investors in our securities.

Deterioration of economic conditions could negatively impact our business.

Our business may be adversely affected by changes in national or global economic conditions, including inflation, interest rates, availability of capital markets, consumer spending rates, energy availability and costs (including fuel surcharges) and the effects of governmental initiatives to manage economic conditions. Any such changes could adversely affect the demand for our products or the cost and availability of our needed raw materials, cooking ingredients and packaging materials, thereby negatively affecting our financial results.

The recent disruptions in credit and other financial markets and deterioration of national and global economic conditions, could, among other things:

- § make it more difficult or costly for us to obtain financing for our operations or investments or to refinance our debt in the future;
- § cause our lenders to depart from prior credit industry practice and make more difficult or expensive the granting of any technical or other waivers under our credit agreements to the extent we may seek them in the future;
- § impair the financial condition of some of our customers, suppliers or counterparties to our derivative instruments, thereby increasing bad debts or non-performance by suppliers;
- § negatively impact global demand for protein products, which could result in a reduction of sales, operating income and cash flows;
- § decrease the value of our investments in equity and debt securities, including our company-owned life insurance and pension plan assets, which could result in higher pension cost and funding requirements; and
- § impair the financial viability of our insurers.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs(1)	
October 27 to November 27, 2008	378,889(2) (3)	\$ 13.87	—		2,873,430	

November 28 to December 28, 2008	—	—	—	2,873,430
December 29, 2008 to February 1, 2009	—	—	—	2,873,430
Total	378,889	13.87	—	2,873,430

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- (1) As of February 1, 2009, our board of directors had authorized the repurchase of up to 20,000,000 shares of our common stock. The original repurchase plan was announced on May 6, 1999 and increases in the number of shares we may repurchase under the plan were authorized on December 15, 1999, January 20, 2000, February 26, 2001, February 14, 2002 and June 2, 2005. There is no expiration date for this repurchase plan.
- (2) The purchases of 12,202 shares for the period of October 27 to November 27, 2008 were made in open market transactions and such shares are held in a rabbi trust to mirror deferred stock grants and fee deferrals made under the Smithfield Foods, Inc. 2008 Incentive Compensation Plan.
- (3) The purchases of 366,687 shares for the period of October 27 to November 27, 2008 were made in open market transactions for contribution to our Supplemental Executive Retirement Plan.



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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Exhibit 3.1 —Articles of Amendment effective August 29, 2001 to the Amended and Restated Articles of Incorporation, including the Amended and Restated Articles of Incorporation of the Company, as amended to date (incorporated by reference to Exhibit 3.1 to the Company's Amendment No. 1 to Quarterly Report on Form 10-Q filed with the SEC on September 12, 2001).

Exhibit 3.2 —Amendment to the Bylaws effective August 27, 2008, including the Bylaws of the Company, as amended to date (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on September 3, 2008).

Exhibit 4.1 —Third Amendment, dated as of January 30, 2009, to the Revolving Credit Agreement, dated as of August 19, 2005, among the Company, the Subsidiary Guarantors from time to time party thereto, the lenders from time to time party thereto, Calyon New York Branch, Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. "Rabobank International," New York Branch and SunTrust Bank, as co-documentation agents, Citicorp USA, Inc., as syndication agent and JPMorgan Chase Bank, N.A., as administrative agent, relating to a \$1,300,000,000 secured revolving credit facility, as amended (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on February 6, 2009).

Exhibit 4.2 —€300,000,000 Multicurrency Revolving Facility Agreement dated August 22, 2006 (as amended and restated by a Supplemental Agreement dated February 11, 2009) among Smithfield Capital Europe, B.V., as borrower, Smithfield Foods, Inc., as guarantor, certain other obligors, BNP Paribas and Société Générale, as arrangers, and the lenders party thereto (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed with the SEC on February 13, 2009).

Exhibit 4.3 —First Amendment, dated February 27, 2009, to the Credit Agreement, dated as of August 29, 2008, among the Company, the lender party thereto, and Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A. "Rabobank Nederland," New York Branch, as Administrative Agent (filed herewith).

Registrant hereby agrees to furnish the SEC, upon request, other instruments defining the rights of holders of long-term debt of the Registrant.

- Exhibit 31.1 —Certification of C. Larry Pope, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- Exhibit 31.2 —Certification of Robert W. Manly, IV, Executive Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- Exhibit 32.1 —Certification of C. Larry Pope, President and Chief Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- Exhibit 32.2 —Certification of Robert W. Manly, IV, Executive Vice President and Chief Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

/s/ Robert W. Manly, IV  
Robert W. Manly, IV  
Vice President and Chief Financial  
Officer

/s/ Kenneth M. Sullivan  
Kenneth M. Sullivan  
Vice President and Chief Accounting  
Officer

Date: March 13, 2009