

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

OCWEN FINANCIAL CORP  
Form 10-Q  
August 09, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

Commission File No. 1-13219

Ocwen Financial Corporation

-----  
(Exact name of registrant as specified in its charter)

Florida

65-0039856

-----  
(State or other jurisdiction  
of incorporation or organization)

-----  
(I.R.S. Employer  
Identification No.)

1661 Worthington Road, Suite 100, West Palm Beach, Florida 33409

-----  
(Address of principal executive offices) (Zip Code)

(561) 682-8000

-----  
(Registrant's telephone number, including area code)

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

Number of shares of Common Stock, \$0.01 par value, outstanding as of August 3,

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

2006: 62,430,116 shares.

OCWEN FINANCIAL CORPORATION  
FORM 10-Q

INDEX

=====

PART I - FINANCIAL INFORMATION

Item 1. Interim Consolidated Financial Statements (Unaudited).....

    Consolidated Balance Sheet at June 30, 2006 and December 31, 2005.....

    Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2006 a

    Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June

    Consolidated Statement of Changes in Stockholders' Equity for the Six Months Ended June

    Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2006 and 2005...

    Notes to Consolidated Financial Statements.....

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations...

Item 3. Quantitative and Qualitative Disclosures About Market Risk.....

Item 4. Controls and Procedures.....

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.....

Item 1A. Risk Factors.....

Item 4. Submission of Matters to a Vote of Security Holders.....

Item 6. Exhibits.....

Signatures .....

PART I - FINANCIAL INFORMATION  
ITEM 1. INTERIM FINANCIAL STATEMENTS (Unaudited)

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands, except share data)

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

	June 30, 2006	Dec
	-----	-----
<b>Assets</b>		
Cash .....	\$ 193,129	\$
Trading securities, at fair value		
Investment grade .....	202,444	
Subordinates and residuals .....	57,421	
Loans held for resale, at lower of cost or market value .....	114,485	
Advances .....	263,963	
Match funded advances .....	351,593	
Mortgage servicing rights .....	151,501	
Receivables .....	60,738	
Deferred tax assets, net .....	171,300	
Premises and equipment, net .....	37,446	
Other assets .....	55,655	
	-----	-----
Total assets .....	\$ 1,659,675	\$
	=====	=====
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Match funded liabilities .....	\$ 313,963	\$
Servicer liabilities .....	395,936	
Lines of credit and other secured borrowings .....	187,835	
Debt securities .....	150,329	
Other liabilities .....	93,283	
	-----	-----
Total liabilities .....	1,141,346	
	-----	-----
Minority interest in subsidiaries .....	1,892	
Commitments and Contingencies (Note 9)		
<b>Stockholders' Equity</b>		
Common stock, \$.01 par value; 200,000,000 shares authorized; 62,429,907 and 63,133,471 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively .....	624	
Additional paid-in capital .....	176,320	
Retained earnings .....	338,817	
Accumulated other comprehensive income (loss), net of taxes .....	676	
	-----	-----
Total stockholders' equity .....	516,437	
	-----	-----
Total liabilities and stockholders' equity .....	\$ 1,659,675	\$
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

For the periods ended June 30,	Three months		Six
	2006	2005	2006
<b>Revenue</b>			
Servicing and subservicing fees .....	\$ 82,772	\$ 71,651	\$ 162,857
Process management fees .....	18,837	17,454	38,149
Other revenues .....	3,527	2,910	6,580
Total revenue .....	105,136	92,015	207,586
<b>Operating expenses</b>			
Compensation and benefits .....	22,006	24,355	47,707
Amortization of servicing rights .....	27,663	24,930	53,952
Servicing and origination .....	12,707	15,148	25,904
Technology and communications .....	6,034	7,862	12,673
Professional services .....	7,620	5,715	15,399
Occupancy and equipment .....	4,823	4,571	9,799
Other operating expenses .....	3,561	3,468	6,294
Total operating expenses .....	84,414	86,049	171,728
<b>Other income (expense)</b>			
Interest income .....	6,298	6,764	24,411
Interest expense .....	(10,062)	(9,072)	(27,316)
Gain (loss) on trading securities .....	1,701	(1,269)	1,327
Loss on loans held for resale, net .....	(3,437)	--	(1,221)
Other, net .....	2,172	2,784	5,793
Other income (expense), net .....	(3,328)	(793)	2,994
Income before income taxes .....	17,394	5,173	38,852
Income tax expense (benefit) .....	(141,692)	2,265	(136,767)
Net income .....	\$ 159,086	\$ 2,908	\$ 175,619
<b>Earnings per share</b>			
Basic .....	\$ 2.53	\$ 0.05	\$ 2.79
Diluted .....	\$ 2.23	\$ 0.05	\$ 2.47
<b>Weighted average common shares outstanding</b>			
Basic .....	62,821,428	62,809,286	63,033,454
Diluted .....	71,767,873	63,709,246	71,876,666

The accompanying notes are an integral part of these consolidated financial statements

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

(Dollars in thousands)

For the periods ended June 30,	Three months	
	2006	2005
Net income .....	\$ 159,086	\$ 2,
Other comprehensive income (loss), net of taxes:		
Change in unrealized foreign currency translation adjustment arising during the period (1) .....	996	(
Comprehensive income .....	\$ 160,082	\$ 2,

(1) Net of tax benefit (expense) of \$(585) and \$305 for the three months and of \$(799) and \$127 for the six months ended June 30, 2006 and 2005, respectively.

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE SIX MONTHS ENDED JUNE 30, 2006  
(Dollars in thousands)

	Common Stock		Additional Paid-in Capital	Retaine Earning
	Shares	Amount		
Balance at December 31, 2005 .....	63,133,471	\$ 631	\$ 184,262	\$ 163,
Net income .....	--	--	--	175,
Issuance of common stock awards to employees .....	77,011	1	660	
Exercise of common stock options .....	217,096	2	1,141	
Repurchase of common stock .....	(1,000,000)	(10)	(10,990)	
Purchase of fractional shares in connection with a reverse/forward stock split .....	(1,259)	--	(14)	
Excess tax benefits related to share- based awards .....	--	--	422	
Employee compensation - Share-based awards .....	--	--	819	
Director's compensation - Common stock .....	3,588	--	20	
Other comprehensive income, net of taxes .....	--	--	--	
Balance at June 30, 2006 .....	62,429,907	\$ 624	\$ 176,320	\$ 338,

=====

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Dollars in thousands)

For the six months ended June 30,

-----	
Cash flows from operating activities	
Net income .....	
Adjustments to reconcile net income to net cash provided (used) by operating activities	
Net cash provided (used) by trading activities .....	
Purchases of loans held for resale .....	
Originations of loans held for resale .....	
Principal payments received on loans held for resale .....	
Proceeds from sales and securitizations of loans held for resale .....	
Premium amortization (discount accretion) on securities, net .....	
Amortization of servicing rights .....	
Depreciation and other amortization .....	
Provision for bad debts .....	
Loss (gain) on trading securities .....	
Gain on sale of deposits .....	
Loss on loans held for resale, net .....	
Gain on sale of real estate .....	
Reversal of valuation allowance on deferred tax asset .....	
Excess tax benefits from the exercise of stock options .....	
Decrease (increase) in advances and match funded advances .....	
Decrease (increase) in deferred tax asset other than reversal of valuation allowance .....	
Decrease (increase) in receivables and other assets, net .....	
Increase in servicer liabilities .....	
Increase in other liabilities, net .....	
Other .....	
Net cash provided by operating activities .....	
 Cash flows from investing activities	
Principal payments received on match funded loans .....	
Purchase of mortgage servicing rights .....	
Principal payments received on loans .....	
Purchases, originations and funded commitments on loans .....	
Additions to premises and equipment .....	
Proceeds from the sale of real estate .....	
Proceeds from the sale of a subsidiary .....	
Net cash from consolidated VIE .....	
Net cash used by investing activities .....	
 Cash flows from financing activities	
Decrease in deposits and escrow deposits .....	
Sale of deposits .....	

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Premium received on sale of deposits .....	
Proceeds from (repayments of) lines of credit and other secured borrowings, net .....	
Proceeds from (repayments of) match funded liabilities, net .....	
Repayment of debt securities .....	
Excess tax benefits from the exercise of stock options .....	
Repurchase of common stock .....	
Exercise of common stock options .....	
Net cash used by financing activities .....	
Net decrease in cash .....	
Cash at beginning of period .....	
Cash at end of period .....	

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
JUNE 30, 2006  
(Dollars in thousands, except share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Ocwen Financial Corporation ("OCN"), through its subsidiaries, is engaged in business activities related to residential and commercial servicing, consumer unsecured debt collections, loan origination services and business process outsourcing. At June 30, 2006, OCN owned all of the outstanding stock of its primary subsidiaries: Ocwen Loan Servicing, LLC ("OLS"), Investors Mortgage Insurance Holding Company and Ocwen Financial Solutions, Private Limited ("India"). Effective June 30, 2005, Ocwen Federal Bank FSB (the "Bank"), a wholly owned subsidiary, voluntarily terminated its status as a federal savings bank and dissolved, a process we referred to as "debanking".

Basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared in conformity with the instructions of the Securities and Exchange Commission ("SEC") to Form 10-Q and SEC Regulation S-X, Article 10, Rule 10-01 for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, the accompanying unaudited financial statements contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. The results of operations and other data for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for any other interim period or for the entire year ending December 31, 2006. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

In preparing the consolidated financial statements, we are required to

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the balance sheet and revenues and expenses for the periods covered. Material estimates that are particularly significant in the near or medium term relate to our valuation of securities, servicing rights, intangibles and deferred tax assets, as well as to our determination of valuation allowances for other asset categories. Actual results could differ from those estimates and assumptions.

Prior to debanking, our consolidated financial statements followed the presentation requirements of Regulation S-X, Article 9, Bank Holding Companies. As a result of debanking, effective December 31, 2005, we revised the presentation of our consolidated financial statements to better align our presentation with the growth and significance of loan servicing and loan origination and outsourcing services, our principal businesses. The principal change in our consolidated financial statements for the periods presented as compared to the presentation in prior periods is in the format of our consolidated statement of operations. In adopting the new format for our consolidated statement of operations, we have made a number of reclassifications of expenses. The most significant of these reclassifications has been to report as operating expenses amounts that were netted against the revenues that were previously reported as servicing and related fees. These expenses are directly related to the generation of revenues and are reported in our consolidated statement of operations as amortization of servicing rights and as components of servicing and origination. Servicing and origination includes expenses of \$9,144 and \$17,787 for the three and six months ended June 30, 2005, respectively, that had previously been netted against revenues reported in servicing and other fees. Similarly, expenses previously included in loan expenses on the consolidated statement of operations are also principally reported as components of servicing and origination expense.

Revenues that are associated with our Residential Origination Services and Business Processing Outsourcing business segments are reported in a separate revenue category, process management fees. These revenues were previously reported as a component of servicing and related fees. Other categories of income, including interest income and interest expense, which were previously reported as revenues but which were not related to the operations of our principal business segments, are reported in other income (expense).

In addition, we created a new liability caption, servicer liabilities, in our consolidated balance sheet. This caption represents amounts that we have collected from borrowers that will be remitted to off-balance sheet custodial accounts, paid directly to investment trusts or refunded to borrowers. Previously, the amounts included in servicer liabilities had been reported either as escrow deposits or as reductions of our cash balances.

8

Amounts included in our 2005 consolidated financial statements have been reclassified to conform to these changes in presentation in our consolidated statement of operations as well as to conform to certain other, less significant, reclassifications that have been made in our consolidated financial statements in 2006.

### Principles of Consolidation

We evaluate special purpose entities first for classification as a "qualifying special purpose entity" ("QSPE") as specified by Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"). Where we determine that a special purpose entity is classified as a QSPE, it is excluded from our



## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

consolidated financial statements. Where we determine that a special purpose entity is not classified as a QSPE, it is further evaluated for classification as a variable interest entity ("VIE") as specified by FASB Interpretation No. 46, "Consolidation of Variable Interest Entities", as revised. When a special purpose entity meets the definition of a VIE, and OCN is identified as the primary beneficiary of the entity, it is included in our consolidated financial statements. The most significant of the VIEs identified during the reported periods is engaged in the origination, acquisition and subsequent securitization or sale of subprime single family residential loans. During the second quarter of 2006, our voting interest in this consolidated VIE exceeded 50%, and we now treat it as a majority-owned subsidiary. The creditors of the remaining VIEs have no recourse against OCN.

All material intercompany accounts and transactions have been eliminated in consolidation. We report minority interests in our majority-owned subsidiaries as a separate item on our consolidated balance sheets. Minority interest in our earnings is included in other income (expense), net, on our consolidated statements of operations.

### NOTE 2 CURRENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 123(R), "Share-Based Payment" and Staff Accounting Bulletin No. 107 (SAB 107), "Share-Based Payment". SFAS No. 123(R) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award - the requisite service period. The determination of compensation expense under SFAS 123(R) also includes the estimation of expected forfeitures, which we previously recognized as incurred. Prior to January 1, 2006, we followed the guidance of Accounting Principles Board ("APB") Opinion No. 25, which provided for accounting for share-based compensation using the intrinsic value method and recognizing compensation costs for such stock options to the extent that the exercise price was less than the price of the stock at the grant date.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123(R), using the modified prospective method. Accordingly, results for prior periods have not been restated. Compensation and benefits expense for the six months ended June 30, 2006 includes \$530 (\$345 after tax) related to stock options. As a result of adopting FAS 123(R), incremental compensation expense related to stock options for the six months ended June 30, 2006 was \$248 (\$161 after tax).

There were no new option grants during the six months ended June 30, 2006, however, 217,096 stock options were exercised and 35,459 were forfeited during that period. At June 30, 2006, a total of 3,977,919 stock options were outstanding, of which 3,152,235 were exercisable. Cash received from the exercise of stock options during the six months ended June 30, 2006 was \$874. Financing cash inflows for that same period include \$422 of tax benefits arising from related tax deductions that reduce the amount of income taxes that would otherwise be payable. The total intrinsic value of stock options exercised, which is defined as the amount by which the market value of the stock on the date of exercise exceeds the exercise price, was \$1,362 for the six months ended June 30, 2006. As of June 30, 2006, unrecognized compensation costs related to non-vested stock options amounted to \$2,379, which will be recognized over a weighted-average remaining requisite service period of approximately 2.7 years.

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." In February 2006, the FASB issued SFAS No. 155 as an amendment to SFAS No. 133 and SFAS No. 140. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

instrument on a fair value basis. The standard also: a) Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; b) Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; c) Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and d) Amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial

9

instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006.

SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140." FASB issued SFAS No. 156 in March 2006 as an amendment to SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and liabilities. Recognition of a servicing asset or liability would be required each time an entity commits to service a financial asset through a servicing contract that: a) represents a transfer of the servicer's financial assets that meets the requirements for sale accounting, b) represents a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with SFAS 115. "Accounting for Certain Investments in Debt and Equity Securities", or c) represents an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.

SFAS 156 also requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practicable, and allows an entity to chose from two subsequent measurement methods for each class of separately recognized servicing assets and liabilities. The two methods are: a) the amortization method which amortizes servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assesses servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date, and b) the fair value measurement method which measures servicing assets or liabilities at fair value each reporting date and reports changes in fair value in earnings in the period in which the changes occur.

A prospective application of SFAS 156 is required as of the beginning of an entity's first fiscal year that begins after September 15, 2006. As of June 30, 2006, the estimated fair value of our mortgage servicing rights was \$222,479 as compared to a carrying value of \$151,501. These amounts include \$2,003 of commercial mortgage servicing rights that were acquired on June 20, 2006. The fair market value of these servicing rights approximates carrying value at June 30, 2006.

### NOTE 3 BASIC AND DILUTED EARNINGS PER SHARE

We are required to present both basic and diluted earnings per share ("EPS") on the face of our statement of operations. Basic EPS excludes common stock equivalents and is calculated by dividing net income by the weighted average number of common shares outstanding during the year. We calculate diluted EPS by dividing net income, as adjusted to add back interest expense on

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

the 3.25% Contingent Convertible Senior Unsecured Notes due 2024 ("Convertible Notes"), by the weighted average number of common shares outstanding including the potential dilutive common shares related to outstanding stock options, restricted stock awards and the Convertible Notes.

The following is a reconciliation of the calculation of basic EPS to diluted EPS for the periods ended June 30:

	Three months	
	2006	2005
<b>Basic EPS:</b>		
-----		
Net income .....	\$ 159,086	\$ 2,908
	=====	=====
Weighted average shares of common stock .....	62,821,428	62,809,286
	=====	=====
Basic EPS .....	\$ 2.53	\$ 0.05
	=====	=====
<b>Diluted EPS:</b>		
-----		
Net income .....	\$ 159,086	\$ 2,908
Interest expense on Convertible Notes, net of income tax (1) ....	779	--
	-----	-----
Adjusted net income .....	\$ 159,865	\$ 2,908
	=====	=====
Weighted average shares of common stock .....	62,821,428	62,809,286
Effect of dilutive elements:		
Convertible Notes (1) .....	7,962,205	--
Stock options (2) .....	913,125	798,015
Common stock awards .....	71,115	101,945
	-----	-----
Dilutive weighted average shares of common stock .....	71,767,873	63,709,246
	=====	=====
Diluted EPS .....	\$ 2.23	\$ 0.05
	=====	=====

10

(1) The effect of our Convertible Notes on diluted EPS is computed using the if-converted method. Interest expense and related amortization costs applicable to the Convertible Notes, net of income tax, are added back to net income. Conversion of the Convertible Notes into shares of common stock has not been assumed for purposes of computing diluted EPS for the three and six months ended June 30, 2005 because the effect would be anti-dilutive. The effect is anti-dilutive whenever interest expense on the Convertible Notes, net of income tax, per common share obtainable on conversion exceeds basic EPS.

(2) Excludes an average of 1,085,903 and 1,629,171 of options that were anti-dilutive for the second quarter of 2006 and 2005, respectively,

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

because their exercise price was greater than the average market price of our stock. Year to date, an average of 1,301,693 and 1,630,605 options were anti-dilutive for 2006 and 2005, respectively.

At OCN's Annual Meeting on May 4, 2006, the shareholders approved a proposal to amend OCN's Articles of Incorporation to effect a 1-for-10 reverse stock split, followed immediately by a 10-for-1 forward stock split (the "Reverse/Forward Split"). We completed the Reverse/Forward Split on May 12, 2006 (the "Effective Date").

As a result of the Reverse/Forward Split, accounts with less than ten shares of common stock were converted on the Effective Date into the right to receive a cash payment for each share held equal in value to the average official closing price of the common stock on The New York Stock Exchange over the ten trading days immediately preceding the Effective Date. A total of 1,259 shares have been retired to date at a cost of \$11.29 per share. Ultimately, a total of 2,385 shares held by 1,127 shareholders will be retired. All shareholder accounts holding ten shares or more were unaffected, and the total number of shares held by such accounts did not change. The Reverse/Forward Split had an insignificant effect on EPS.

#### NOTE 4 DERIVATIVE FINANCIAL INSTRUMENTS

Our derivative contracts are exchange-traded; therefore, holders of these instruments look to the exchange for performance under these contracts and not to the holders of the offsetting futures contracts. Using exchange-traded instruments minimizes our exposure to risk from nonperformance under these contracts. The notional amount of our contracts does not represent our exposure to credit loss.

#### Foreign Currency Exchange Rate Risk Management

Our primary exposure to foreign currency exchange rates relates to the British Pound versus the U.S. Dollar. We entered into foreign currency futures contracts to hedge our net investment in a foreign subsidiary that owns residual securities backed by subprime residential loans originated in the United Kingdom ("UK"). Currency futures are commitments to either purchase or sell foreign currency at a future date for a specified price. Our policy is to periodically adjust the amount of foreign currency derivative contracts we have entered into in response to changes in both our recorded investment in the subsidiary and to changes in our assets denominated in a foreign currency.

We have determined that the local currency of our investment in UK residuals is the functional currency. The foreign currency derivative financial instrument related to our investment in the UK residuals was designated as a hedge. Accordingly, for this instrument we include the gains or losses in the net unrealized foreign currency translation in accumulated other comprehensive income in stockholders' equity.

The following table sets forth the terms and values of the British Pound foreign currency futures at the dates indicated:

	Position	Maturity	Notional Amount
	-----	-----	-----
June 30, 2006:			
-----			
British Pound currency futures (1) .....	Short	Sept. 2006	(pound) 12,875

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

December 31, 2005:  
-----

British Pound currency futures (1) ..... Short March 2006 (pound) 13,438

(1) The U.S. Dollar equivalent notional amount of the British Pound currency futures was \$23,796 and \$23,148 at June 30, 2006 and December 31, 2005, respectively.

Beginning in the second quarter of 2005, Bankhaus Oswald Kruber GmbH & Co. KG ("BOK"), entered into Euro foreign exchange forward ("FX Forward") contracts in order to hedge its investment in U.S. dollar-denominated servicing advances that it acquired from OLS. The remaining advances were repurchased by OLS in the second quarter of 2006. The following table sets forth the terms and value of the foreign exchange forward contracts at the dates indicated:

11

Maturity	Notional Amount		Contract Rate
	Sell	Buy	
 June 30, 2006: -----			
August 2006	\$ 3,000	(euro) 2,440	1.2291 to 1.22304
 December 31, 2005: -----			
April to August 2006	\$ 7,464	(euro) 6,111	1.1854 to 1.2590

The fair value of our FX Forward contracts represents the estimated amount that we would receive or pay to terminate these agreements taking into account current interest rates. Since the FX Forward contracts were not designated as hedges, changes in the fair value of the contracts and gains and losses from these instruments are included in earnings in the period in which they occur, and we report them as a component of other income (expense), net. The net realized and unrealized gains included in earnings to record these contracts at fair value were \$311 during the second quarter of 2006 and \$464 for the six months ended June 30, 2006.

### Interest Rate Risk Management

In connection with our Residential Origination Services business, we acquire certain mortgage loan portfolios with the intention of selling or securitizing them within a short period of time. Since the value of the mortgage loans is subject to interest rate risk prior to being sold or securitized, we have sold short a series of three-month Eurodollar interest rate futures contracts to hedge the exposure to interest rate risk represented by our loans held for resale. Our policy is to adjust the amount of Eurodollar futures contracts that we sell short to accommodate changes in the amount of our mortgage loans held for resale. Since the Eurodollar interest rate futures contracts were not designated as hedges, changes in the fair value of the contracts and gains and losses from these instruments are included in earnings in the period in which they occur, and we report them as a component of other income (expense), net.

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

The following table sets forth the terms and values of our Eurodollar interest rate futures contracts as at the dates indicated:

Position	Maturity	Notional Amount	Contract Price
June 30, 2006:			
Short	September 2006 to June 2010	\$ 1,154,000	94.32 to 95.40
December 31, 2005:			
Short	March 2006 to September 2010	\$ 3,261,000	94.92 to 95.46

The fair value of our Eurodollar interest rate futures contracts represents the estimated amount that we would receive or pay to terminate these agreements taking into account current interest rates. The net realized and unrealized gains included in earnings to record these contracts at fair value were \$1,251 during the second quarter of 2006 and \$2,898 for the six months ended June 30, 2006. The following table summarizes our use of interest rate risk management instruments:

	Notional Amount Short Eurodollar Interest Rate Futures
Balance at December 31, 2005.....	\$ 3,261,000
Sales.....	1,914,000
Maturities.....	(639,000)
Terminations.....	(3,382,000)
Balance at June 30, 2006 .....	\$ 1,154,000

### NOTE 5 REGULATORY MATTERS

Effective June 30, 2005, the Bank terminated its status as a federal savings bank. Prior to returning its original thrift charter to the Office of Thrift Supervision ("OTS"), the Bank operated as a federal savings bank, and OCN was a registered savings and loan holding company. Our primary regulatory authority was the OTS.

Pursuant to the conditions set forth in the OTS Approval, OCN entered into an agreement (the "Guaranty") in favor of the OTS and any holders of claims with respect to liabilities assumed by OLS from the Bank (the "Assumed Liabilities"). Assumed Liabilities include all legal actions against the Bank. Assumed liabilities do not include the customer deposit and other liabilities that were assumed by Marathon National Bank of New York ("Marathon") in

connection with the Branch Purchase and Deposit Assumption agreement. The Guaranty contains affirmative covenants relating to the maintenance of a \$5,000 cash collateral account, reporting requirements, transactions with affiliates, preservation of the existence of our subsidiaries and maintenance of not less than \$35,000 of unencumbered financial assets. Pursuant to the Guaranty, we have also agreed to certain limits on the incurrence of debt, merger or sale transactions, disposition of assets and payment of dividends. As of June 30,

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

2006, we were in compliance with all of the covenants specified in the Guaranty.

The Guaranty will remain in effect until the later of (a) the sixth anniversary of the date on which the Bank's federal bank charter was cancelled or (b) the date on which we have paid in full (i) any obligations that arise out of the Assumed Liabilities with respect to which a claim has been asserted on or prior to the sixth anniversary of the date on which the Bank's federal bank charter was cancelled and (ii) all other amounts payable by us under the Guaranty.

Effective June 30, 2005, the Supervisory Agreement that the Bank and OTS had entered into on April 19, 2004 terminated because we were no longer a FDIC-insured institution. The OTS retains, for a period of six years after termination of the Supervisory Agreement, the right to bring enforcement actions in respect of any breach or noncompliance by the Bank with the Supervisory Agreement, or other applicable regulations, that may have occurred prior to debanking.

We have continued the Bank's residential mortgage servicing business under OLS, which is a licensed servicer in all fifty states, the District of Columbia and Puerto Rico. As a result of debanking, we are no longer able to accept deposits in the U.S or benefit from federal preemption with regard to post-debanking activities. OLS is subject to the rules and regulations of various Federal agencies, Fannie Mae, Freddie Mac, Ginnie Mae and state regulatory authorities

BOK is licensed as a credit institution (Kreditinstitut) under the laws of the Federal Republic of Germany and is supervised and regulated in Germany by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, or BaFin), the German Central Bank (Deutsche Bundesbank) and, in respect of minimum reserves on deposits, the European Central Bank. BOK, under its license, may engage not only in a number of traditional banking activities such as deposit and lending business, but also in investment banking, underwriting and securities trading transactions, both for its own account and for customers. BOK is currently not material to our operations.

### NOTE 6 INCOME TAXES

The following table provides details of our income tax expense for the periods indicated:

	Three months		
For the periods ended June 30,	2006	2005	
Income tax expense on income before taxes .....	\$ 3,519	\$ 1,141	\$
Reversal of valuation allowance on deferred tax assets ....	(145,211)	(843)	
Provision for recapture of base year bad debt reserves ....	--	1,967	
Total income tax expense (benefit) .....	\$ (141,692)	\$ 2,265	\$
	=====	=====	=====

In the second quarter of 2006, we reversed \$145,211 of valuation allowances on our deferred tax assets in order to increase the net deferred tax asset to the amount that is more likely than not to be realized in future periods. In addition, \$4,794 of capital losses expired which resulted in equal and offsetting declines in both the gross deferred tax asset and valuation

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

allowance but had no impact on the net deferred tax asset balance or income tax expense. As a result, our valuation allowance declined from \$163,802 at December 31, 2005 to \$13,797 at June 30, 2006. The remaining valuation allowance includes \$5,115 related to capital loss carryforwards.

We maintain a valuation allowance in an amount sufficient to reduce our deferred tax asset to the amount that is more likely than not to be realized. The amount of the valuation allowance is based on consideration of all available evidence, both positive and negative, including our recent earnings history, current tax position and estimates of future taxable income. The tax character (ordinary versus capital) and the carry forward and carry back periods of certain tax attributes (e.g., capital losses and tax credits) are also considered. We assess the amount of our valuation allowance each quarter.

In assessing the amount of the valuation allowance in the second quarter of 2006, our determination that it was appropriate to reverse \$145,211 was primarily based on the following:

- o Cumulative earnings in recent periods;
- o Positive outlook for future earnings, including positive changes in the market factors affecting our Residential Servicing business that suggest continued strong earnings performance;
- o The disposal of nearly all of our non-core assets.

13

In the second quarter of 2005, we recorded a one-time provision of \$1,967 (\$1,124 net of a related reversal of the valuation allowance on the deferred tax asset) to recognize a deferred tax liability arising from the recapture of bad debt reserves in connection with our termination of the Bank's status as a federal savings bank.

Income tax expense on income before income taxes differs from amounts that would be computed by applying the Federal corporate income tax rate of 35% primarily because of the effect of foreign taxes, foreign income with an indefinite deferral from U.S. taxation, losses from consolidated VIEs, state taxes, low-income housing tax credits and changes in the deferred tax valuation allowance. Excluding the effect of the reversal of valuation allowances on deferred tax assets in the second quarter of 2006, our effective tax rate was 21.73% for the first six months of 2006. Excluding the effect of the one-time provision for the recapture of bad debt reserves in the second quarter of 2005, our effective tax rate was 20.85% for the first six months of 2005. We estimate our effective tax rate based on projected full-year results, and we revise the estimate quarterly during the year.

### NOTE 7 BUSINESS SEGMENT REPORTING

A brief description of our business segments, aligned within our two areas of focus, is as follows:

#### Servicing

-----

- o Residential Servicing. Through this business we provide loan servicing including asset management and resolution services to third party owners of subprime residential mortgage and high loan-to-value loans for a fee. We acquire the rights to service loans by purchasing them or by entering into subservicing contracts. This segment also includes our residential loan servicing system product (REALServicing).
- o Commercial Servicing. This segment includes the results of both our



## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

domestic and international servicing of commercial assets (loans and real estate), as well as our commercial loan servicing product (REALSynergy). International servicing is conducted through Global Servicing Solutions, LLC ("GSS").

- o Ocwen Recovery Group. This business primarily conducts collection activities for third party owners of unsecured receivables and for a portfolio of unsecured credit card receivables that we acquired during the period 1998 through 2000.

### Loan Processing and Origination Services

-----

- o Residential Origination Services. This business provides various loan origination services, including residential property valuation services, mortgage due diligence, fulfillment, title services and loan refinancing for Residential Servicing customers. This segment also includes our subprime loan origination activities, internet-based vendor management system product (REALTrans) and subprime residual trading securities.
- o Business Process Outsourcing. This business segment began operations in December 2002. Business Process Outsourcing provides outsourcing services to third parties including mortgage underwriting, data entry, call center services and mortgage research.

Corporate Items and Other. This segment includes items of revenue and expense that are not directly related to a business including business activities that are individually insignificant, interest income on short-term investments of cash and the related costs of financing these investments and certain other corporate expenses.

We allocate interest income and expense to each business segment for the investment of funds raised or funding of investments made. We also allocate expenses generated by corporate support services to each business segment.

Financial information for our segments is as follows at the dates and for the periods indicated:

	Total Assets	
	June 30, 2006	December 31, 2005
Residential Servicing .....	\$ 804,709	\$ 783,560
Commercial Servicing .....	9,462	6,433
Ocwen Recovery Group .....	874	1,002
Residential Origination Services .....	189,713	679,432
Business Process Outsourcing .....	2,008	1,193
	-----	-----
	1,006,766	1,471,620
Corporate Items and Other .....	652,909	382,513
	-----	-----
	\$ 1,659,675	\$ 1,854,133
	=====	=====

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

-----			
For the three months ended June 30, 2006			
-----			
Residential Servicing .....	\$ 82,969	\$ 58,658	\$ (6,163)
Commercial Servicing .....	3,084	2,784	(18)
Ocwen Recovery Group .....	1,856	1,928	192
Residential Origination Services .....	14,431	17,551	1,037
Business Process Outsourcing .....	2,656	1,963	(7)
	-----	-----	-----
	104,996	82,884	(4,959)
Corporate Items and Other .....	140	1,530	1,631
	-----	-----	-----
	\$ 105,136	\$ 84,414	\$ (3,328)
	=====	=====	=====
For the three months ended June 30, 2005			
-----			
Residential Servicing .....	\$ 68,459	\$ 60,644	\$ (5,215)
Commercial Servicing .....	4,558	4,025	(198)
Ocwen Recovery Group .....	3,274	3,057	27
Residential Origination Services .....	12,870	13,259	2,113
Business Process Outsourcing .....	2,858	2,575	(19)
	-----	-----	-----
	92,019	83,560	(3,292)
Corporate Items and Other .....	(4)	2,489	2,499
	-----	-----	-----
	\$ 92,015	\$ 86,049	\$ (793)
	=====	=====	=====
For the six months ended June 30, 2006			
-----			
Residential Servicing .....	\$ 162,911	\$ 114,288	\$ (12,607)
Commercial Servicing .....	6,199	5,634	(18)
Ocwen Recovery Group .....	4,057	4,561	274
Residential Origination Services .....	29,006	38,310	12,244
Business Process Outsourcing .....	5,379	4,688	(17)
	-----	-----	-----
	207,552	167,481	(124)
Corporate Items and Other .....	34	4,247	3,118
	-----	-----	-----
	\$ 207,586	\$ 171,728	\$ 2,994
	=====	=====	=====
For the six months ended June 30, 2005			
-----			
Residential Servicing .....	\$ 136,906	\$ 122,040	\$ (9,319)
Commercial Servicing .....	8,999	8,398	(245)
Ocwen Recovery Group .....	7,086	6,454	117
Residential Origination Services .....	25,137	24,340	3,761
Business Process Outsourcing .....	5,443	5,030	(51)
	-----	-----	-----
	183,571	166,262	(5,737)
Corporate Items and Other .....	(68)	4,476	1,082
	-----	-----	-----
	\$ 183,503	\$ 170,738	\$ (4,655)
	=====	=====	=====

NOTE 8 ACQUISITION

OCN and Charlesbank Equity Fund VI, Limited Partnership and related funds (collectively, "Charlesbank") recently formed BMS Holdings, Inc. ("BMS

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Holdings") for the purpose of effecting the purchase of Bankruptcy Management Solutions, Inc. ("BMS"), a leading provider of bankruptcy case management software solutions to Chapter 7 Bankruptcy Trustees. On July 31, 2006, the acquisition of all of the issued and outstanding shares of BMS from its stockholders and a warrant holder was completed. The total amount of the investment in this acquisition was approximately \$445,000, including the purchase price of the BMS shares and related fees and expenses. OCN and Charlesbank each contributed approximately \$45,000 in equity. Approximately \$347,000 of the purchase price was funded by BMS through the issuance of senior and subordinated debt. We do not anticipate that we will be required to include BMS Holdings in our consolidated financial statements. We will account for our investment in BMS Holdings using the equity method of accounting.

15

The acquisition will be accounted for by BMS Holdings as a purchase, and, accordingly, BMS Holdings will allocate the purchase price to the underlying tangible and identifiable intangible assets acquired and liabilities assumed based upon their estimated fair values at the date of the acquisition. The allocation of the purchase price may be subject to change based on final estimates of fair value.

### NOTE 9 COMMITMENTS AND CONTINGENCIES

At June 30, 2006, we had commitments of \$52,764 to fund loans secured by mortgages on single family residential properties. We also have commitments to sell \$22,293 of loans held for resale, generally within 30 days of funding.

Through our investment in subordinated residual securities, which had a fair value of \$57,421 at June 30, 2006, we support senior classes of securities. Principal from the underlying mortgage loans generally is allocated first to the senior classes, with the most senior class having a priority right to the cash flow from the mortgage loans until its payment requirements are satisfied. To the extent that there are defaults and unrecoverable losses on the underlying mortgage loans, resulting in reduced cash flows, the most subordinate security will be the first to bear this loss. Because subordinate and residual interests generally have no credit support, to the extent there are realized losses on the mortgage loans comprising the mortgage collateral for such debt securities, we may not recover our remaining investment.

Under the terms of the sales agreements entered into in connection with the sale of certain of our affordable housing properties, we have a commitment to fund cash deficits that may arise from the operations of those properties. The remaining term of these commitments ranges from one to six years. The obligation under these commitments was \$3,789 as of June 30, 2006. Any operating deficits we fund are supported by a promissory note to be repaid to us from future cash flows of the property. In addition, we have provided to the purchasers of certain affordable housing properties guaranties against the possible recapture of future tax credits. We have never experienced a recapture of tax credits on any of the affordable housing properties in which we invested or sold. We have not recognized these guaranties as a liability because the probability of recapture is considered remote.

Under the terms of the Assignment and Assumption agreement, OLS has become the successor to the Bank with respect to all legal actions. Therefore, any references to the Bank in connection with the following legal matters pertain to OLS as successor.

On April 13, 2004, the United States Judicial Panel on Multi-district Litigation granted our petition to transfer and consolidate a number of lawsuits against the Bank, OCN and various third parties arising out of the servicing of

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

plaintiffs' mortgage loans into a single case to proceed in the United States District Court for the Northern District of Illinois under caption styled: In re Ocwen Federal Bank FSB Mortgage Servicing Litigation, MDL Docket No. 1604 (the "MDL Proceeding"). Currently, there are approximately 48 lawsuits consolidated in the MDL Proceeding involving 64 mortgage loans that we currently or previously serviced. Additional similar lawsuits have been brought in other courts, some of which may be transferred to and consolidated in the MDL Proceeding. The borrowers in many of these lawsuits seek class action certification. Others have brought individual actions. No class has been certified in the MDL Proceeding or any related lawsuits. On May 19, 2006, plaintiffs filed an Amended Consolidated Class Action Complaint containing various claims under federal statutes, including the Real Estate Settlement Procedures Act and Fair Debt Collection Practices Act, federal bankruptcy laws, state deceptive trade practices statutes and common law. The claims are generally based on allegations of improper loan servicing practices, including (i) charging borrowers allegedly improper or unnecessary fees such as breach letter fees, hazard insurance premiums, foreclosure-related fees, late fees, property inspection fees and bankruptcy-related fees; (ii) untimely posting and misapplication of borrower payments; and (iii) improperly treating borrowers as in default on their loans. While the Consolidated Complaint does not set forth any specific amounts of claimed damages, plaintiffs are not precluded from requesting leave from the court to amend the Consolidated Complaint or otherwise seeking damages should the matter proceed to trial. On April 25, 2005, the court entered an Opinion and Order granting the Bank partial summary judgment finding that, as a matter of law, the mortgage loan contracts signed by plaintiffs authorize the imposition of breach letter fees and other legitimate default or foreclosure related expenses. The court explained that its ruling was in favor of defendants to the specific and limited extent that plaintiffs' claims challenge the propriety of the above-mentioned fees. On May 16, 2006, after having denied defendants' motions to dismiss various portions of the Consolidated Complaint on federal preemption and procedural grounds, as well as our motion to dismiss OCN from the case for lack of personal jurisdiction, the court granted our motion to take an interlocutory appeal on the federal preemption issue. On July 29, 2006, the United States Court of Appeals for the Seventh Circuit granted our request to hear our appeal on the federal preemption issue.

On June 2, 2006, settlements in principle were reached with the law firms representing plaintiff-borrowers in 23 of the cases consolidated in the MDL Proceeding and in a number of similar filed and threatened cases primarily in the states of Alabama and Mississippi. None of these cases sought class certification. The settlements in principle are subject to the completion of definitive settlement and release agreements to be separately entered into with each of the individual plaintiff-borrowers involved. We cannot currently determine the ultimate outcome of the remaining cases in the MDL Proceeding or the other matters described above and have not established additional accruals in respect thereof. We believe the allegations in the MDL Proceeding are without merit and will continue to vigorously defend against them.

On November 3, 2004, the trial judge in litigation brought by Cartel Asset Management, Inc. ("Cartel") against OCN, the Bank and Ocwen Technology Xchange, Inc. ("OTX"), a subsidiary that has been dissolved, in federal court in Denver, Colorado entered final judgment in the amount of \$520 against OTX and

nominal damages of two dollars against the Bank. In the November 3, 2004 order, the judge reduced a prior jury verdict in the amount of \$9,320 after trial on this matter involving allegations of misappropriation of trade secrets and contract-related claims brought by a former vendor. The litigation does not relate to our Residential Servicing business. Notwithstanding the nominal damage

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

award against the Bank, it was assessed a statutory award to Cartel of attorneys' fees in an additional amount of \$170, and the Bank and OTX were further assessed costs in the amount of \$9. Cartel and defendants are pursuing cross-appeals in the United States Court of Appeals for the Tenth Circuit. We intend to continue to vigorously defend this matter.

On February 8, 2005, a jury in Circuit Court for Palm Beach County, Florida returned verdicts of \$1,000 and \$1,056 in compensatory damages in favor of two former employees of the Bank in a lawsuit against OCN and the Bank. The jury rejected plaintiffs' request for punitive damages. The plaintiffs brought claims under the Florida Civil Rights Act, the Florida Whistleblower Act and state tort law, arising out of an alleged invasion of privacy and related incidents allegedly committed by other former employees of the Bank in 1998 for which plaintiffs sought to hold the Ocwen defendants vicariously liable. We believe the verdicts, which were reduced to final judgments on May 20, 2005, as well as an additional award of \$900 in plaintiffs' attorneys' fees, are against the weight of evidence and contrary to law. We intend to continue to vigorously defend this matter and have taken an appeal to the Florida Court of Appeals.

On February 9, 2006, the County Court for Galveston County, Texas entered judgment in the amount of \$1,830 against Ocwen and in favor of a plaintiff-borrower who defaulted on a mortgage loan that we serviced. The plaintiff claimed that Ocwen's foreclosure on the loan violated the Texas Deceptive Trade Practices Act and other state statutes and common law. This judgment reduced a prior jury verdict of \$11,500. We believe the judgment, comprised of \$5 in actual damages, approximately \$675 in emotional distress, statutory and other damages and interest, and \$1,150 for attorneys' fees, is against the weight of evidence and contrary to law. We intend to continue to vigorously defend this matter and have taken an appeal to the Texas Court of Appeals.

OCN is subject to various other pending legal proceedings. In our opinion, the resolution of these proceedings will not have a material effect on our financial condition, results of operations or cash flows. We continuously monitor the status of our litigation, including advice from external legal counsel, and perform periodic assessments of our litigation for potential loss accrual and disclosure. We accrue for judgments and maintain litigation accruals when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. Accordingly, in the second quarter, we increased our accrual by \$2,950, primarily in anticipation of the June 2, 2006 settlements in principle referred to above.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in thousand, except share data)

The following discussion of our results of operations, consolidated financial condition and capital resources and liquidity should be read in conjunction with our Selected Consolidated Financial Information, Consolidated Financial Statements and the related notes, all included elsewhere herein.

#### RISK FACTORS AND CRITICAL ACCOUNTING POLICIES

##### Risk Factors

We include a discussion of the principal risks and uncertainties that affect or could affect our business operations under Item 1A on pages 8 through 12 of our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes to this information during 2006.

##### Critical Accounting Policies

Our ability to measure and report our operating results and financial

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

position is heavily influenced by the need to estimate the impact or outcome of risks in the marketplace or other future events. Our critical accounting policies are those that relate to the estimation and measurement of these risks. Because they inherently involve significant judgments and uncertainties, an understanding of these policies is fundamental to understanding Management's Discussion and Analysis of Results of Operations and Financial Condition. Our significant accounting policies are discussed in detail on pages 17 through 19 of Management's Discussion and Analysis of Results of Operations and Financial Condition and in Note 1 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes to this information during 2006.

### Forward Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to the following:

- o projections for growth of the residential loan servicing business and business opportunities in other core businesses;

17

- o assumptions related to the sources of liquidity and the adequacy of financial resources;
- o assumptions related to prepayment speeds and delinquency rates and the value of mortgage servicing rights;
- o estimates regarding interest rates and foreign currency transactions; and
- o expectations related to pending litigation.

Forward-looking statements are not guarantees of future performance, and involve a number of assumptions, risks and uncertainties that could cause actual results to differ materially. Important factors that could cause actual results to differ materially from those suggested by the forward-looking statements include, but are not limited to, the following:

- o general economic and market conditions,
- o prevailing interest or currency exchange rates,
- o availability of servicing rights for purchase,
- o governmental regulations and policies,
- o international political and economic uncertainty,
- o availability of adequate and timely sources of liquidity,
- o uncertainty related to dispute resolution and litigation, and
- o real estate market conditions and trends.

Further information on the risks specific to our business are detailed within this report and our other reports and filings with the Securities and Exchange Commission, including our periodic report on Form 10-K for the year ended December 31, 2005, Form 10-Q for the quarter ended March 31, 2006 and our Forms 8-K filed during 2006. The forward-looking statements speak only as of the date they are made and should not be relied upon. OCN undertakes no obligation to update or revise the forward-looking statements.

### OVERVIEW

#### Changes in Financial Condition

June 30,	December 31,	Increase
----------	--------------	----------

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

	2006	2005	(Decrease)
	-----	-----	-----
Assets .....	\$ 1,659,675	\$ 1,854,133	\$ (194,458)
Liabilities .....	1,141,346	1,504,873	(363,527)
Minority interest in subsidiaries .....	1,892	1,853	39
Stockholder's equity .....	516,437	347,407	169,030

- o The \$194,458 decrease in total assets is primarily due to a \$510,186 reduction in loans held for resale, largely reflecting two securitization transactions that closed during the first six months of the year. This reduction was partially offset by a \$151,030 increase in net deferred tax assets, a \$124,277 increase in cash and investment grade securities and a \$27,144 increase in subordinate and residual securities. The increase in deferred tax assets, net, resulted primarily from the reversal of \$145,211 of valuation allowances in the second quarter.
- o The \$363,527 decrease in total liabilities is largely the result of a \$438,613 decline in amounts due under lines of credit and other secured borrowings, primarily reflecting reduced funding requirements on the lower balance of loans held for resale. At June 30, 2006 we had \$215,161 of unused stated borrowing capacity on our existing credit facilities.
- o The \$169,030 increase in stockholder's equity is primarily due to net income of \$175,619 partially offset by the repurchase of 1,000,000 shares of common stock.

Results of Operations

For the periods ended June 30,	Three Months		Favorable (Unfavorable)	Six M
	2006	2005		2006
-----	-----	-----	-----	-----
Revenue .....	\$ 105,136	\$ 92,015	\$ 13,121	\$ 207,586
Operating expenses .....	84,414	86,049	1,635	171,728
Other income (expense), net ....	(3,328)	(793)	(2,535)	2,994
	-----	-----	-----	-----
Income before income taxes .....	17,394	5,173	12,221	38,852
Income tax expense (benefit) ...	(141,692)	2,265	143,957	(136,767)
	-----	-----	-----	-----
Net income .....	\$ 159,086	\$ 2,908	\$ 156,178	\$ 175,619
	=====	=====	=====	=====
Earnings per share:				
Basic .....	\$ 2.53	\$ 0.05	\$ 2.48	\$ 2.79
Diluted .....	\$ 2.23	\$ 0.05	\$ 2.18	\$ 2.47

- o The improvement in revenue primarily reflects increased revenue from the Residential Servicing segment due to higher servicing fees on a larger servicing portfolio and the positive impact of rising short-term interest rates on revenue from custodial accounts ("float earnings").
- o Income before income taxes in 2006 primarily reflects the continued strong performance of our Residential Servicing segment. Pre-tax income of this

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

segment was \$18,148 and \$36,016 for the second quarter and first six months of 2006, respectively, as compared to \$2,600 and \$5,547 for the same periods of 2005. This improvement is due to higher revenues, as discussed above, and a reduction in total operating expenses, including a reduction in interest paid to investors related to loan pay-offs. All of our other segments were profitable in the second quarter of 2006 except for Residential Origination Services, which incurred a pre-tax loss of \$(2,083), although year to date results are profitable with pre-tax income of \$2,940. The loss for the quarter primarily relates to loan securitization and origination activities, which are profitable year to date.

- o The net tax benefit for the 2006 periods includes the reversal of \$145,211 of deferred tax asset valuation allowances during the second quarter to increase the net deferred tax asset to the amount that is more likely than not to be realized in future periods.

We provide additional financial information and discuss our segment results in the following section.

### SEGMENTS

We are reviewing our business segment reporting structure based on the evolving alignment of our business activities and may elect to modify our reporting segments in the future. The following section provides a discussion of the changes in financial condition of our business segments during the six months ended June 30, 2006 and a discussion of pre-tax results of operations of our business segments for the three and six-month periods ended June 30, 2006 and 2005.

The following table presents the assets and liabilities of each of our business segments at June 30, 2006:

	Residential Servicing	Commercial Servicing	Ocwen Recovery Group	Residential Origination Services	Busi Pro Outso
	-----	-----	-----	-----	-----
<b>Assets</b>					
Cash .....	\$ --	\$ 3,694	\$ --	\$ 361	\$ --
Trading securities:					
Investment grade .....	--	--	--	--	--
Subordinates and residuals .	--	--	--	56,631	--
Loans held for resale .....	--	--	--	114,485	--
Advances .....	258,989	156	--	3,712	--
Match funded advances .....	351,593	--	--	--	--
Mortgage servicing rights .....	149,498	2,003	--	--	--
Receivables .....	23,999	3,153	791	9,662	--
Deferred tax asset, net .....	--	--	--	--	--
Premises and equipment .....	1,568	226	75	1,115	--
Other assets .....	19,062	230	8	3,747	--
	-----	-----	-----	-----	-----
Total assets .....	\$ 804,709	\$ 9,462	\$ 874	\$ 189,713	\$ --
	=====	=====	=====	=====	=====
<b>Liabilities</b>					
Match funded liabilities .....	\$ 313,963	\$ --	\$ --	\$ --	\$ --
Servicer liabilities .....	395,936	--	--	--	--
Lines of credit and other secured borrowings .....	103,528	--	--	69,826	--



Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Debt securities .....	--	--	--	--	--
Other liabilities .....	41,767	3,207	2,444	3,559	
	-----	-----	-----	-----	-----
Total liabilities .....	\$ 855,194	\$ 3,207	\$ 2,444	\$ 73,385	\$
	=====	=====	=====	=====	=====

19

The following tables present the pre-tax statements of operations for each of our business segments for the six months ended June 30, 2006:

	Residential Servicing	Commercial Servicing	Ocwen Recovery Group	Residential Origination Services	Busin Proc Outsou
	-----	-----	-----	-----	-----
Revenue					
Servicing and subservicing					
fees .....	\$ 155,733	\$ 3,079	\$ 4,057	\$ 315	\$
Process management fees .....	4,032	2	--	28,507	
Other revenues .....	3,146	3,118	--	184	
	-----	-----	-----	-----	-----
Total revenue .....	162,911	6,199	4,057	29,006	
	-----	-----	-----	-----	-----
Operating expenses					
Compensation and benefits .....	15,447	3,066	1,869	12,204	
Amortization of servicing					
rights .....	53,938	14	--	--	
Servicing and origination .....	12,752	14	206	12,932	
Technology and communications .	10,352	967	822	3,897	
Professional services .....	8,048	353	88	3,036	
Occupancy and equipment .....	5,401	322	511	1,323	
Other operating expenses .....	8,350	898	1,065	4,918	
	-----	-----	-----	-----	-----
Total operating expenses ...	114,288	5,634	4,561	38,310	
	-----	-----	-----	-----	-----
Other income (expense)					
Interest income .....	262	18	--	20,075	
Interest expense .....	(13,111)	(7)	(4)	(12,246)	
Gain (loss) on trading					
securities .....	--	--	--	1,910	
Gain (loss) on loans held					
for resale, net .....	--	--	--	(1,221)	
Other, net .....	242	(29)	278	3,726	
	-----	-----	-----	-----	-----
Other income (expense),					
net .....	(12,607)	(18)	274	12,244	
	-----	-----	-----	-----	-----
Pre tax income (loss) .....	\$ 36,016	\$ 547	\$ (230)	\$ 2,940	\$
	=====	=====	=====	=====	=====

Residential Servicing

The following table sets forth information regarding residential loans and real estate serviced for others:

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

	Loans (1) (2) (3)		Real Estate		Total
	Amount	Count	Amount	Count	
June 30, 2006:					
Performing .....	\$ 40,341,746	332,879	\$ --	--	\$ 40,341,746
Non-Performing .....	5,510,538	57,030	1,234,812	13,947	6,745,380
	-----	-----	-----	-----	-----
	\$ 45,852,284	389,909	\$ 1,234,812	13,947	\$ 47,087,096
	=====	=====	=====	=====	=====
December 31, 2005:					
Performing .....	\$ 36,532,664	297,649	\$ --	--	\$ 36,532,664
Non-performing .....	5,125,116	57,420	1,121,268	13,733	6,246,484
	-----	-----	-----	-----	-----
	\$ 41,657,780	355,069	\$ 1,121,268	13,733	\$ 42,779,048
	=====	=====	=====	=====	=====

- (1) At June 30, 2006 we serviced 289,312 subprime loans with a total unpaid principal balance of \$ 37,751,125 as compared to 304,234 subprime loans with an unpaid principal balance of \$37,429,090 at December 31, 2005. Subprime loans represent residential loans we service that were made to borrowers who generally did not qualify under guidelines of Fannie Mae and Freddie Mac ("nonconforming loans").
- (2) Non-performing loans have been delinquent for 90 days or more. Performing loans are current or have been delinquent for less than 90 days.
- (3) We serviced under subservicing contracts 124,565 residential loans with an unpaid principal balance of \$12,520,215 as of June 30, 2006. This compares to 105,873 residential loans with an unpaid principal balance of \$10,983,237 serviced under subservicing contracts at December 31, 2005.
- (4) At June 30, 2005, we serviced a total of 346,708 assets with an unpaid principal balance of \$38,662,177. The average unpaid principal balance serviced was \$46,257,247 and \$44,647,625 for the three and six months ended June 30, 2006, respectively, as compared to \$37,624,152 and \$37,210,939 for the same periods of 2005.

20

The following table sets forth information regarding the changes in our portfolio of residential assets serviced for others:

	Amount		Count
	2006	2005	
For the six months ended June 30,			2006
-----	-----	-----	-----
Servicing portfolio at beginning of period ....	\$ 42,779,048	34,524,491	368,802
Additions .....	18,004,632	18,198,257	136,257
Less: Runoff .....	(13,696,584)	(14,060,571)	(101,203)
	-----	-----	-----
Servicing portfolio at end of period .....	\$ 47,087,096	\$ 38,662,177	403,856
	=====	=====	=====

Additions primarily represent servicing purchased from the owners of the mortgages, servicing retained in connection with the securitization of our own loans and servicing obtained by entering into subservicing agreements with other entities that own the servicing rights.

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Comparative selected balance sheet data is as follows:

	June 30, 2006	December 31, 2005
	-----	-----
Total assets .....	\$ 804,709	\$ 783,560
Advances .....	258,989	215,207
Match funded advances .....	351,593	377,105
Mortgage servicing rights .....	149,498	148,663
Receivables .....	23,999	23,323
Total liabilities .....	\$ 855,194	\$ 745,760
Match funded liabilities .....	313,963	339,292
Servicer liabilities .....	395,936	298,892
Lines of credit and other secured borrowings .....	103,528	81,218

Advances. During any period in which the borrower is not making payments, we are required under certain servicing agreements to advance our own funds to meet contractual principal and interest remittance requirements for investors, pay property taxes and insurance premiums and process foreclosures. Advances on loans serviced for others consist of the following:

	June 30, 2006	December 31, 2005
	-----	-----
Principal and interest .....	\$ 67,132	\$ 40,201
Taxes and insurance .....	92,875	98,331
Other .....	98,982	76,675
	-----	-----
	\$ 258,989	\$ 215,207
	=====	=====

We are entitled to recover advances from borrowers for reinstated and performing loans and from investors for foreclosed loans. We record a charge to earnings to the extent that advances are uncollectible under provisions of the servicing contracts, taking into consideration historical loss and delinquency experience, length of delinquency and the amount of the advance. Advances on loans serviced for others are net of reserves of \$490 and \$570 as of June 30, 2006 and December 31, 2005, respectively.

Match Funded Advances. Match funded advances consist of the following:

	June 30, 2006	December 31, 2005
	-----	-----
Principal and interest .....	\$ 148,787	\$ 174,252
Taxes and insurance .....	125,799	129,700
Other .....	77,007	73,153
	-----	-----
	\$ 351,593	\$ 377,105
	=====	=====

Match funded advances on loans serviced for others resulted from our transfers of residential loan servicing related advances to third parties in exchange for cash. We retain control of the advances, and therefore the transfers do not qualify as sales for accounting purposes. As a result, we

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

report the amount of proceeds received from the transfers as secured borrowings with a pledge of collateral (match funded liabilities). Match funded advances are owned by special purpose entities and are, therefore, not available to satisfy general claims of creditors.

21

Mortgage Servicing Rights. The unamortized balance of mortgage servicing rights is primarily related to subprime residential loans. Mortgage servicing rights increased by \$835 during the first six months of 2006 as purchases were slightly higher than amortization.

Balance at December 31, 2005 .....	\$	148,663
Purchases .....		50,689
Retained from the securitization of loans .....		4,084
Amortization .....		(53,938)
		-----
Balance at June 30, 2006 .....	\$	149,498
		=====

We purchase servicing rights from the owners of the mortgages or retain them in connection with the securitization of our own loans. At June 30, 2006 we serviced loans under 459 servicing agreements for 30 investors. This compares to 466 servicing agreements for 22 investors at December 31, 2005.

Receivables. Receivables related to the Residential Servicing business include \$8,547 and \$15,674 at June 30, 2006 and December 31, 2005, respectively, representing fees earned from the servicing of loans and real estate. The remaining balance consists principally of reimbursable expenses due from loan servicing investors. The total balance of receivables for this segment is net of reserves of \$5,710 and \$6,509 at June 30, 2006 and December 31, 2005, respectively.

Match Funded Liabilities. Match funded liabilities are obligations secured by the collateral underlying the related match funded assets, and are repaid through the cash proceeds arising from those assets. We account for and report match funded liabilities as secured borrowings with pledges of collateral. We are currently negotiating enhanced funding provisions and other revisions to one of our match funded agreements. If these revisions are approved, future transfers of advances under this facility may qualify as sales for accounting purposes, which would result in a loss, although such a change would also eliminate the interest expense we currently record related to these transactions.

				Balance Outs
Collateral	Interest Rate	Unused Borrowing Capacity	June 30, 2006	D
-----	-----	-----	-----	-----
Advances (1)	See (1) below	\$ 54,743	\$ 220,257	\$
Advances (2)	1-Month LIBOR + 175 basis points	31,294	93,706	
		-----	-----	
		\$ 86,037	\$ 313,963	\$
		=====	=====	=

(1) In November 2004, we executed a servicing advance securitization. This

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

transaction involved the issuance of a term note for \$100,000 and a one-year variable funding note for a maximum of \$75,000. On March 31, 2005, we executed an indenture supplement to the November 2004 securitization with a closing date of April 6, 2005. This supplement included the issuance of a second term note for \$75,000. In addition, the maximum amount of the variable funding note was increased to \$100,000. The original term note bears interest at LIBOR plus 50 basis points, and the second term note bears interest at LIBOR plus 40 basis points. The variable funding note bears interest at a commercial paper rate plus a margin. This rate approximates LIBOR plus 50 basis points. The original term note under this facility has a stated maturity of October 2013, and the second term note has a stated maturity of March 2014. The variable funding note has a stated maturity of November 2011. The 1-Month LIBOR was 5.33% and 4.39% at June 30, 2006 and December 31, 2005, respectively.

- (2) Under the terms of the agreement, we are eligible to finance additional advances on loans serviced for others up to a maximum balance of \$125,000. This facility will mature in January 2007.

**Servicer Liabilities.** Servicer liabilities represent amounts that we have collected, primarily from Residential Servicing borrowers, that will be deposited in custodial accounts and excluded from our balance sheet, paid directly to an investment trust or refunded to borrowers. The principal components of servicer liabilities are as follows:

	June 30, 2006	December 31, 2005
	-----	-----
Borrower payments due to custodial accounts .....	\$ 323,071	\$ 225,862
Escrow payments due to custodial accounts .....	8,563	22,573
Partial payments and other unapplied balances ....	64,302	50,457
	-----	-----
	\$ 395,936	\$ 298,892
	=====	=====

22

**Lines of Credit and Other Secured Borrowings.** Secured line of credit arrangements are as follows:

Borrowing Type	Interest Rate	Maturity	Unused Borrowing Capacity	----- Jun
Senior secured credit agreement (1)	1-Month LIBOR + 162.5 or 225 basis points	August 2006 (2)	\$ 36,472	\$

- (1) Secured by mortgage servicing rights and advances on loans serviced for others. Borrowing secured by mortgage servicing rights is at LIBOR plus 225 basis points. Borrowing secured by advances is at LIBOR plus 162.5 basis points. The interest rate may be reduced to 1.625% or 2.25% to the extent that we have available balances on deposit with the lender.

- (2) The lenders agreed to extend the maturity of this facility from June 30, 2006 to August 31, 2006. We are currently negotiating to renew and increase

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

the size of this facility and expect to complete these negotiations before the current maturity date.

Comparative selected operations data is as follows:

For the periods ended June 30,	Three months		Six months	
	2006	2005	2006	2005
Pre-tax income .....	\$ 18,148	\$ 2,600	\$ 36,016	\$
Revenue:				
Servicing and subservicing fees .....	\$ 79,720	\$ 65,736	\$ 155,733	\$
Process management fees .....	1,964	1,753	4,032	
Other .....	1,285	970	3,146	
Total revenue .....	\$ 82,969	\$ 68,459	\$ 162,911	\$
Operating expenses:				
Compensation and benefits .....	\$ 7,602	\$ 9,117	\$ 15,447	\$
Amortization of servicing rights .....	27,649	24,930	53,938	
Servicing and origination .....	6,641	9,271	12,752	
Technology and communications .....	5,376	5,948	10,352	
Professional services .....	4,999	3,687	8,048	
Occupancy and equipment .....	2,710	2,645	5,401	
Other .....	3,681	5,046	8,350	
Total operating expenses .....	\$ 58,658	\$ 60,644	\$ 114,288	\$
Other income (expense):				
Interest income .....	\$ 145	\$ 77	\$ 262	\$
Interest expense .....	(6,549)	(5,284)	(13,111)	
Other .....	241	(8)	242	
Total other income (expense) .....	\$ (6,163)	\$ (5,215)	\$ (12,607)	\$

Servicing and Subservicing Fees. The principal components of servicing and subservicing fees are provided in the table below:

For the periods ended June 30,	Three months		
	2006	2005	2006
Servicing and subservicing fees .....	\$ 50,247	\$ 44,143	\$ 100,
Late charges .....	9,096	8,624	18,
Revenue from custodial accounts (float earnings) .....	13,113	6,558	21,
Prepayment and collection related fees .....	2,424	2,217	4,
Other fees .....	4,840	4,194	10,
	\$ 79,720	\$ 65,736	\$ 155,

The increase in servicing and subservicing fees in the 2006 periods as compared to the same periods of 2005 is primarily due to the increase in the average balance of loans serviced. Total servicing and subservicing fees for the

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

three and six months ended June 30, 2006 increased by 21% and 19%, respectively, as compared to the same periods of 2005. The increase in the average balance is due to growth in the loan servicing portfolio and reduced run-off of the existing portfolio due to slower prepayment speeds. The average balance of assets serviced during the three and six months ended June 30, 2006 increased by 23% and 20%, respectively, as compared to the 2005 periods. Second quarter and year to date 2006 prepayment speeds averaged 30%. This compares to an average of

23

40% and 38% in the second quarter and year to date periods of 2005. The decline in mortgage prepayment speeds is largely due to rising mortgage interest rates and a leveling off of the gains in housing values.

Increases in short-term interest rates have had a positive impact on float earnings. Although the average balance of funds that we have received from borrowers but which are held in custodial accounts until remitted to investors has declined in the 2006 periods, the average yield we earned on these funds increased. The following table summarizes information regarding float earnings:

For the periods ended June 30,	Three months		Six months	
	2006	2005	2006	2005
Average custodial account balances .....	\$ 1,004,300	\$ 1,270,400	\$ 994,397	\$ 1,111,111
Float earnings .....	\$ 13,113	\$ 6,558	\$ 21,935	\$ 11,111
Annualized yield .....	5.22%	2.06%	4.41%	2.06%

Custodial accounts are excluded from our balance sheet. The decline in the average balance in the 2006 periods is primarily due to a decline in mortgage prepayment speeds offset by the increase in the average balance of loans serviced. The underlying servicing agreements restrict the investment of float balances to certain types of instruments. We are responsible for any losses incurred on the investment of these funds.

Compensation and Benefits Expense. The decrease in compensation expense and benefits in the second quarter and first six months of 2006 as compared to the same periods of 2005 has occurred primarily due to a decline in the average number of employees in the U.S. as a result of cost reduction initiatives put in place in 2005, including a greater utilization of the lower cost workforce in India. Although average employment in India increased in the 2006 periods, total average employment declined, and the ratio of India employment to total employment increased as compared to the 2005 periods.

Average employment in the Residential Servicing segment is as follows:

For the periods ended June 30,	Three months		Six months	
	2006	2005	2006	2005
India .....	978	958	946	920
United States .....	418	536	430	573
	1,396	1,494	1,376	1,493

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Amortization of Servicing Rights. Amortization expense for the second quarter 2006 increased by \$2,719, or 11%, as compared to the second quarter of 2005. Year to date, amortization expense for 2006 increased by \$3,893, or 8%, as compared to 2005. This increase in amortization expense in the 2006 periods is due to an increase in our investment in mortgage servicing rights, offset by a reduction in the rate of amortization primarily as a result of slower mortgage prepayment speeds.

Servicing and Origination Expenses. The principal components of servicing and origination expenses are as follows:

For the periods ended June 30,	Three months		Six months	
	2006	2005	2006	2005
Compensating interest expense .....	\$ 3,645	\$ 6,158	\$ 6,660	\$ 11,8
Satisfaction expense .....	1,358	1,779	2,954	3,2
Other .....	1,638	1,334	3,138	3,0
	\$ 6,641	\$ 9,271	\$ 12,752	\$ 18,1

The primary reason for the decline in compensating interest expense in the second quarter and first six months of 2006 as compared to the same periods of 2005 is a shift towards a higher percentage of loans serviced under a mid-month structure versus a calendar month structure. Under a calendar month structure, compensating interest is paid to the securitization trust for a full month of interest on all loans that prepay during the month, whereas under a mid-month structure we are not obligated to pay the compensating interest on prepayments that occur during the first half of the month. The decline in compensating interest expense attributed to slower prepayment speeds experienced in 2006 has been largely offset by an increase in the average size of the loan servicing portfolio during that same period.

Professional Services Expenses. Professional services expense for the 2006 periods includes a provision of \$2,950 recorded in the second quarter to increase litigation accruals related to ongoing cases. This increase in litigation accruals is primarily related to settlements in principle that were reached on June 2, 2006 with the law firms representing plaintiff-borrowers in 23 of the cases consolidated in the MDL Proceeding and in a number of similar filed and threatened cases primarily in the states of Alabama and Mississippi. None of these cases sought class certification. The settlements in principle are subject to the completion of definitive settlement and release agreements to be separately entered into with each of the individual plaintiff-borrowers involved.

24

Other Operating Expenses. Other consists primarily of overhead allocation charges and bad debt expense. The decrease in other operating expenses in the 2006 periods is due in large part to a decline in bad debt expense. Bad debt expense amounted to \$(59) and \$825 in the second quarter of 2006 and 2005, respectively. Year to date, bad debt expense amounted to \$202 and \$2,951 during 2006 and 2005, respectively. The higher bad debt expense in 2005 was primarily the result of providing for aged reimbursable expenses.

Interest Expense. The increase in interest expense in the 2006 periods primarily reflects an increase in financing costs associated with our servicing



## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

advances that is largely due to higher interest rates.

### Commercial Servicing

Comparative selected balance sheet data is as follows:

	June 30, 2006	December 31, 2005
Total assets .....	\$ 9,462	\$ 6,433
Cash .....	3,694	3,057
Mortgage servicing rights .....	2,003	--
Receivables .....	3,153	2,508
Total liabilities .....	\$ 3,207	\$ 3,220

Mortgage Servicing Rights. On June 20, 2006, our GSS Canada operations acquired the rights to service 75 commercial loans with an unpaid principal balance of \$531,079.

Comparative selected operations data is as follows:

	Three months		Six months	
For the periods ended June 30,	2006	2005	2006	2005
Pre-tax income .....	\$ 282	\$ 335	\$ 547	\$
Revenue:				
Servicing and subservicing fees .....	\$ 1,071	\$ 2,708	\$ 3,079	\$
Other .....	2,013	1,850	3,120	
Total revenue .....	\$ 3,084	\$ 4,558	\$ 6,199	\$
Operating expenses .....	\$ 2,784	\$ 4,025	\$ 5,634	\$

The following table sets forth information regarding commercial loans and real estate serviced for others:

	Loans		Real Estate		Amount
	Amount	Count	Amount	Count	
June 30, 2006:					
Performing .....	\$ 2,727,569	348	\$ --	--	\$ 2,727,569
Non-performing .....	304,140	372	7,427	2	311,567
	\$ 3,031,709	720	\$ 7,427	2	\$ 3,039,136
December 31, 2005:					
Performing .....	\$ 1,389,787	300	\$ --	--	\$ 1,389,787
Non-performing .....	193,635	274	56,719	69	250,394
	\$ 1,583,422	574	\$ 56,719	69	\$ 1,640,181

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

At June 30, 2006, our international offices serviced a total of 508 loans with an unpaid principal balance of \$2,766,700. This compares to 272 loans with an unpaid principal balance of \$1,269,796 serviced at December 31, 2005. The increase in loans serviced by our international offices in 2006 is primarily attributed to our GSS Germany operations, which commenced servicing loans in late 2005. Loans serviced by our GSS Canada operations also increased in 2006 as a result of the acquisition of servicing rights discussed above.

25

Servicing Fees. The principal components of servicing and subservicing fees are as follows:

For the periods ended June 30, -----	Three months		Six months	
	2006	2005	2006	2005
International servicing fees .....	\$ 565	\$ 1,942	\$ 1,963	\$ 3,673
Domestic servicing fees .....	506	766	1,116	2,122
	\$ 1,071	\$ 2,708	\$ 3,079	\$ 5,795
	=====	=====	=====	=====

The decline in international servicing fees in the 2006 periods primarily reflects the sale of our Japan operations in December 2005 partially offset by an increase in servicing fees earned by our GSS Germany and GSS Canada operations. Servicing fees earned by our GSS Japan operations were \$1,690 and \$3,009 for the three and six months ended June 30, 2005, respectively. The decline in domestic servicing fees in 2006 is primarily due to a decline in asset resolution fees.

Operating Expenses. The decline in operating expenses in the 2006 periods is primarily due to the sale of our GSS Japan operations in December 2005. Operating expenses of the GSS Japan subsidiaries that we sold were \$1,083 and \$2,017 for the three and six months ended June 30, 2005, respectively.

Ocwen Recovery Group

Comparative selected operations data is as follows:

For the periods ended June 30, -----	Three months		Six months	
	2006	2005	2006	2005
Pre-tax income (loss) .....	\$ 120	\$ 244	\$ (230)	\$
Revenue:				
Servicing fees:				
Third-party collections .....	\$ 1,707	\$ 2,912	\$ 3,640	\$ 6
Proprietary collections .....	149	362	417	
Total revenue .....	\$ 1,856	\$ 3,274	\$ 4,057	\$ 7
	=====	=====	=====	=====
Operating expenses .....	\$ 1,928	\$ 3,057	\$ 4,561	\$ 6

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

The decline in revenue in the 2006 periods reflects an ongoing shift in revenue from a maturing portfolio of higher margin proprietary assets to lower yielding third-party contracts. The decrease in operating expenses in 2006 is largely the result of ongoing process improvements, technology enhancements and a greater utilization of lower cost resources in India.

### Residential Origination Services

Comparative selected balance sheet data is as follows:

	June 30, 2006	December 31, 2005
	-----	-----
Total assets .....	\$ 189,713	\$ 679,432
Subordinate and residual trading securities .....	56,631	27,023
Loans held for resale .....	114,485	624,671
Receivables .....	9,662	18,497
Total liabilities .....	\$ 73,385	\$ 538,226
Lines of credit and other secured borrowings .....	69,826	530,569

**Trading Securities.** During the first six months of 2006, trading securities increased by \$29,608 largely due to residual securities with a fair value of \$18,919 at June 30, 2006 that were retained in connection with the first and second quarter loan securitizations. We also acquired residual and subordinate securities with a fair value of \$11,053 during the second quarter of 2006. In addition to providing various mortgage due diligence and loan origination services, our strategy in this business includes the targeted acquisition of residual securities. We acquire residual securities directly from third parties or retain them in connection with loan securitization transactions.

Subordinate and residual securities do not have a contractual maturity but are paid down over time as cash distributions are received. The weighted average remaining life of these securities was 3.54 years at June 30, 2006. The anticipated effective yield to maturity as of June 30, 2006 based on the purchase price, actual cash flows received to date and the current estimate of future cash flows under the pricing assumptions at June 30, 2006 was 22.94%. The original anticipated effective yield to maturity based on the purchase price and

26

anticipated future cash flows under pricing assumptions at the time of purchase was 17.87%. Differences in the June 30, 2006 anticipated yield to maturity from that originally anticipated are due to differences between estimated cash flows and actual cash flows. Each quarter, we update the assumptions used to estimate future cash flows based on the actual results to date. The primary assumptions include prepayment speeds, loss rates and the discount rate. The mortgages that underlie our residential trading unrated subprime subordinate and residual securities amounted to \$1,201,917 at June 30, 2006 and are secured by properties located in 50 states, one U.S. territory and the UK. The largest aggregate value of mortgages in any one state, territory or foreign country is \$172,278 in Florida.

**Loans Held for Resale.** Loans held for resale represent single-family residential loans originated or acquired by our Residential Origination Services segment that we intend to sell or securitize. The \$510,186 decline in loans held for resale during the first six months of 2006 is primarily due to the first quarter securitization of loans with a carrying value of \$428,168 that we had

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

acquired during the fourth quarter of 2005. During the second quarter of 2006, we also completed the securitization of loans with a carrying value of \$214,522 that we had acquired primarily during the first quarter of 2006. The aggregate balances related to our other loan refinancing, origination and sale programs have also declined during 2006. Loans held for resale are carried at the lower of cost or market value and were comprised of the following at June 30, 2006:

- o Loans with a carrying value of \$79,148, net of a market valuation reserve of \$185, originated in connection with our subprime origination operations.
- o Loans with a carrying value of \$22,293 originated in response to requests from Residential Servicing customers to refinance their mortgages. Only loans with sales commitments prior to closing are originated under this program. Of the loans outstanding at June 30, 2006, nearly all were sold in July 2006.
- o Loans with a carrying value of \$13,044, net of a market valuation reserve of \$4,481, acquired as a part of our securitization activities. Loans with a carrying value of \$10,996 were acquired during the third quarter of 2005. The remaining loans were acquired during the second quarter of 2006. The carrying value at June 30, 2006 includes \$9,206 of non-performing loans.

Receivables. The \$8,835 decrease in receivables during the first six months of 2006 is primarily due to the collection of interest and other amounts related to loans held for resale, the balance of which has declined significantly since the end of the year, as discussed above.

Lines of Credit and Other Secured Borrowings. Lines of credit and other secured borrowings, which are secured by residential mortgage loans unless otherwise noted, are as follows:

Borrowing Type	Interest Rate	Maturity	Unused Borrowing Capacity
Repurchase agreement (1)	1-Month LIBOR + 75	March 2006	\$ -
Repurchase agreement (2)	Overnight LIBOR + 80 - 110 basis points	June 2007	68,17
Repurchase agreement	1-Month LIBOR + 50 bps	February 2007	2,74
Repurchase agreement (3)	1-month LIBOR +125 bps	April 2036	N/
Master loan and security agreement (4)	1-Month LIBOR + 55 or 355 to 1005 basis points	June 2007	21,72
			\$ 92,65

(1) This agreement matured on March 31, 2006 and was not extended. The loans we acquired in the fourth quarter of 2005 were funded through a transaction involving the sale of loans under this agreement to repurchase, which we accounted for as a collateralized financing. The loans were securitized in the first quarter of 2006, and the outstanding balance was repaid.

(2) The interest rate on this agreement varies based on the type of loan sold. The size of this facility has been reduced to \$75,000, and the maturity date has been extended to June 29, 2007. Overnight LIBOR was 5.37% at June 30, 2006.

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

- (3) This agreement has no stated credit limit. Lending is determined for each transaction based on the acceptability of the securities presented as collateral.
- (4) We, together with two consolidated VIEs, one of which is now consolidated as a majority-owned subsidiary, entered into this agreement on October 11, 2005 and borrowings under this agreement are secured by mortgage loans. We can borrow up to 100% of the principal balance of the mortgage loans or 98% of the market value of the loans whichever is lower. Borrowing up to 90% of the unpaid principal balance of the loans or 88.2% of the market value of the loans bears interest at LIBOR plus 55 basis points. Borrowing above this level bears interest at LIBOR plus 355 to 1005 basis points, depending on the type of loan. Subsequently, the remaining VIE was removed from this facility, and the maximum amount of the facility was reduced to \$75,000.

27

Comparative selected operations data is as follows:

For the periods ended June 30,	Three months	
	2006	2005
Pre-tax income (loss) .....	\$ (2,083)	\$ 1,724
Revenue:		
Process management fees .....	\$ 14,019	\$ 12,833
Other .....	412	37
Total revenue .....	\$ 14,431	\$ 12,870
Operating expenses:		
Compensation and benefits .....	\$ 4,938	\$ 2,747
Servicing and origination .....	5,978	5,740
Technology and communications .....	2,163	2,000
Professional services .....	703	265
Occupancy and equipment .....	716	449
Other .....	3,053	2,058
Total operating expenses .....	\$ 17,551	\$ 13,259
Other income (expense):		
Interest income:		
Subordinate and residual trading securities .....	\$ 3,410	\$ 3,301
Loans held for resale .....	875	4
Other .....	92	2
Total interest income .....	4,377	3,307
Interest expense .....	(2,164)	(416)
Gain (loss) on trading securities .....	1,774	(1,380)
Gain (loss) on loans held for resale, net .....	(3,437)	--
Other, net .....	487	602
Total other income (expense) .....	\$ 1,037	\$ 2,113

Process Management Fees. The principal components of process management fees are:

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

For the periods ended June 30,	Three months		Six months	
	2006	2005	2006	2005
Property valuation fees .....	\$ 6,163	\$ 7,497	\$ 13,245	\$ 14,000
Mortgage due diligence fees .....	2,681	2,176	5,450	3,000
Loan refinancing fees .....	2,232	1,294	4,468	2,000
Other .....	2,943	1,866	5,344	4,000
	<u>\$ 14,019</u>	<u>\$ 12,833</u>	<u>\$ 28,507</u>	<u>\$ 25,000</u>

Other process management fees primarily includes title service and other fees earned from vendors in the REALTrans network.

Compensation and Benefits Expense. Compensation and benefits expense for the 2006 periods include a VIE that we began consolidating as of the end of 2005. This entity is a small start-up subprime loan originator that commenced operations in July 2005. During the second quarter of 2006, our voting interest in this VIE exceeded 50%, and it is now consolidated as a majority-owned subsidiary. Compensation and benefits expense related to this entity amounted to \$1,198 and \$4,065 for the second quarter and first six months of 2006, respectively. In addition, compensation and benefit expenses associated with the mortgage fulfillment center and due diligence operation we acquired in December 2004 increased by \$1,279 and \$3,255 in the three and six month periods ended June 30, 2006, respectively, as compared to the same periods of the prior year. This increase is primarily due to increased staffing as a result of building capacity in this business.

Servicing and Origination Expenses. Servicing and origination expenses consist primarily of fees incurred in connection with the residential property valuation services that we provided. These fees amounted to \$3,868 and \$4,931 during the second quarter of 2006 and 2005, respectively. Year to date, such fees amounted to \$8,181 and \$8,985 during 2006 and 2005, respectively. Servicing and origination expenses also include expenses related to loan refinancing, title services and the subprime originations VIE that we began consolidating as of the end of 2005.

Professional Services Expenses. The increase in professional services in the 2006 periods is primarily due to underwriting fees and other direct costs incurred in connection with the two loan securitization transactions.

Interest Income. The increase in interest income in the second quarter and first six months of 2006 as compared to the same periods of 2005 is largely due to an increase in the average balance of loans held for resale, primarily as a result of acquisitions during the fourth quarter of 2005 and the first quarter of 2006. The consolidation of the subprime originations VIE as of the end of 2005 also contributed to the increase.

Interest Expense. The increase in interest expense in the second quarter and first six months of 2006 as compared to the same periods of 2005 reflects the additional funding requirements as a result of the increase in the average balance of loans held for resale. The increase is also partially attributed to the consolidation of the subprime originations VIE as of the end of 2005.

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Gain (Loss) on Trading Securities. The net gains in the 2006 periods include unrealized gains of \$3,402 and \$2,606 during the second quarter and first six months, respectively, on subordinate and residual securities acquired or retained in connection with securitization transactions. These gains were partly offset by unrealized losses of \$(1,026) and \$(1,873) for the same periods, on unrated subprime residual securities backed by loans originated in the U.K. The net losses on trading securities in the 2005 periods represent unrealized losses on unrated subprime residual securities, primarily those backed by loans originated in the UK. A decline in cash flows from the UK securities as they mature has resulted in reduced interest income and a decline in fair value.

Gain (Loss) on Loans Held for Resale, Net. The components of gain (loss) on loans held for resale, net, are:

	Three months		Six months
For the periods ended June 30,	2006	2005	2006
Gain (loss) on sales and securitizations .....	\$ (1,977)	\$ --	\$ 1,128
Valuation losses .....	(1,460)	--	(2,349)
	\$ (3,437)	\$ --	\$ (1,221)
	=====	=====	=====

During the second quarter, we recorded a loss of \$(2,294) on the securitization of \$214,522 of loans, the majority of which we had acquired during the first quarter of 2006. A gain of \$3,105 was recognized in the first quarter on the securitization of loans with a carrying value of \$428,168 that we had acquired during the fourth quarter of 2005. We determine the gain by allocating the carrying value of the loans between loans sold and the interests retained, based on their relative estimated fair values. The gain on sale that we report represents the difference between the cash proceeds from the sale and the cost allocated to the loans sold. In connection with these securitizations, we retained the mortgage servicing rights and the residual securities. Valuation losses represent charges that we recorded to reduce loans held for resale to market value.

Other, Net. Other income for the second quarter and first six months of 2006 includes \$1,251 and \$2,898, respectively, of net realized and unrealized gains related to Eurodollar interest rate futures contracts.

### Business Process Outsourcing

Comparative selected operations data is as follows:

	Three months		Six months	
For the periods ended June 30,	2006	2005	2006	2005
Pre-tax income (loss) .....	\$ 686	\$ 264	\$ 674	\$ 5,379
Process management fees .....	2,656	2,858	5,379	5,379
Operating expenses .....	1,963	2,575	4,688	5,379

The decline in process management fee revenue in the 2006 periods

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

reflects the loss of a client due to a merger during the first quarter of 2006. Operating expenses have also declined in the 2006 periods, primarily as a result of cost reduction efforts initiated during the second quarter of 2006.

29

### Corporate Items and Other

Comparative selected balance sheet data is as follows:

	June 30, 2006	December 31, 2005
	-----	-----
Total assets .....	\$ 652,909	\$ 382,513
Cash .....	189,074	264,373
Trading securities .....	203,234	4,939
Receivables .....	21,129	21,891
Deferred tax assets, net .....	171,300	20,270
Premises and equipment, net .....	34,458	37,227
Other assets .....	32,608	32,716
Total liabilities .....	\$ 206,981	\$ 214,894
Lines of credit and other secured borrowings .....	14,482	14,661
Debt securities .....	150,329	154,329
Other liabilities .....	42,171	45,904

Trading Securities. The fair value of our trading securities in the Corporate Items and Other segment is as follows:

	June 30, 2006	December 31, 2005
	-----	-----
Investment grade securities:		
Commercial paper .....	\$ 121,232	\$ --
Investment funds .....	73,389	--
Other .....	7,823	1,685
	-----	-----
	202,444	1,685
Subordinates .....	790	3,254
	-----	-----
	\$ 203,234	\$ 4,939
	=====	=====

Receivables. Receivables in this segment consist of the following:

	June 30, 2006	December 31, 2005
	-----	-----
Amounts due from sales of affordable housing properties ....	\$ 12,783	\$ 13,160
Security deposits .....	3,698	3,678
Other .....	4,648	5,053
	-----	-----
	\$ 21,129	\$ 21,891



=====

Payments to be received in future years (through June 2014) from the sale of investments in affordable housing properties are net of unaccreted discounts of \$1,187 and \$1,530 and reserves for doubtful accounts of \$6,531 and \$6,150 at June 30, 2006 and December 31, 2005, respectively. Our final sale of an affordable housing limited partnership investment occurred during 2005.

Deferred tax assets, net. The \$151,030 increase in deferred tax assets, net, in 2006 is primarily due to the reversal of \$145,211 of valuation allowances during the second quarter. This reversal was recorded as an income tax benefit. Based on our positive earnings trend in recent periods and a more stable outlook for future taxable income, we determined that it was appropriate to reverse this portion of the deferred tax asset valuation allowance in order to increase the net deferred tax asset to the amount that we are more likely than not to realize in future periods. In addition, \$4,794 of capital losses expired which resulted in equal and offsetting declines in both the gross deferred tax asset and valuation allowance but had no impact on the net deferred tax asset balance. Deferred tax assets are net of valuation allowances totaling \$13,797 and \$163,802 at June 30, 2006 and December 31, 2005, respectively. See Note 6 to our Interim Consolidated Financial Statements.

30

Other Assets. Other assets held by this segment are comprised of the following:

	June 30, 2006	December 31, 2005
	-----	-----
Interest earning collateral deposits .....	\$ 15,344	\$ 15,164
Deferred debt-related issuance costs .....	4,213	4,755
Goodwill and intangibles .....	5,435	5,435
Real estate .....	3,382	4,062
Prepaid expenses .....	2,945	2,390
Other .....	1,289	910
	-----	-----
	\$ 32,608	\$ 32,716
	=====	=====

Interest earning collateral deposits at both June 30, 2006 and December 31, 2005 include \$8,912 of deposits that were required in order to obtain surety bonds for affordable housing properties that we sold before the end of the fifteen-year tax credit amortization period and on which we have previously claimed tax credits on our income tax returns. Interest earning collateral deposit balances also include a \$5,000 cash collateral account required under the Guaranty we entered into in connection with debanking.

Lines of Credit and Other Secured Borrowings. Lines of credit and other secured borrowings in this segment represent a mortgage note collateralized by our loan servicing call center located in Orlando, Florida. This note has a fixed interest rate of 5.62% and matures in October 2014.

Debt Securities. Debt securities consist of the following:

June 30,  
2006  
-----

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

3.25% Contingent Convertible Senior Unsecured Notes due August 1, 2024 ....	\$	96,900	\$
10.875% Capital Securities due August 1, 2027 .....		53,429	
		-----	-----
	\$	150,329	\$
		=====	=====

The Convertible Notes declined by \$4,000 during 2006 as a result of repurchases during the first quarter that generated total gains of \$25, net of the write-off of unamortized issuance costs.

Other Liabilities. Other liabilities in this segment consist primarily of accruals for incentive compensation awards, audit fees, legal fees and settlements, interest on debt securities and other operating expenses. Other liabilities also include funds of third parties held on deposit by BOK.

Comparative selected operations data is as follows:

For the periods ended June 30	Three months		Six
	2006	2005	2006
Pre-tax income (loss) .....	\$ 241	\$ 6	\$ (1,095)
Revenue .....	\$ 140	\$ (4)	\$ 34
Operating expenses .....	\$ 1,530	\$ 2,489	\$ 4,247
Other income (expense), net:			
Interest income .....	\$ 1,764	\$ 3,236	\$ 4,056
Interest expense .....	(1,347)	(3,201)	(1,931)
Gain (loss) on trading securities .....	(74)	111	(583)
Other, net .....	1,288	2,353	1,576
Total other income (expense) .....	\$ 1,631	\$ 2,499	\$ 3,118
	=====	=====	=====

Operating Expenses. Operating expenses for the quarter ended June 30, 2006 and 2005 include \$1,301 and \$1,271, respectively, of expenses associated with business activities that are individually insignificant, primarily Affordable Housing, Commercial Assets and BOK. Year to date, the expenses associated with these business activities were \$2,633 and \$2,575 for 2006 and 2005, respectively.

Interest Income. The decline in interest income in the second quarter and first six months of 2006 as compared to the same periods of 2005 reflects a decline in cash, investment grade securities and other short-term investments after debanking, offset in part by an increase in interest income on a commercial unrated subordinate security arising out of a cash distribution in the first quarter of 2006.

Interest Expense. The decline in interest expense in the second quarter and first six months of 2006 as compared to the same periods of 2005 is partly due to a decline in interest expense on debt securities as a result of repurchases during the third and fourth quarters of 2005. Also, interest expense for the second quarter and first six months of 2005 included \$1,256 and \$2,915, respectively, on customer deposits prior to debanking. We retained a greater amount of interest expense in the Corporate Items and Other segment in the first

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

six months of 2005, reflecting the high cash balances that we were holding in preparation for debanking.

Gain (Loss) on Trading Securities. The losses in the 2006 periods primarily reflect a decline in the fair value of a commercial unrated subordinate security as a result of a large cash distribution received in the first quarter of 2006. This distribution also resulted in an increase in interest income as previously disclosed.

Other, net. The 2006 periods include a gain of \$1,261 from the sale of a land parcel during the second quarter that had a carrying value of \$844. The 2005 periods include a gain of \$1,750 we recognized in the second quarter in connection with the assumption by Marathon of our customer deposit liabilities on June 30, 2005, as part of debanking.

### MINORITY INTEREST IN SUBSIDIARY

Minority interest of \$1,892 and \$1,853 at June 30, 2006 and December 31, 2005, respectively, primarily represents the investment in GSS by Merrill Lynch, which owns 30% of GSS.

### STOCKHOLDER'S EQUITY

Stockholders' equity amounted to \$516,437 at June 30, 2006 as compared to \$347,407 at December 31, 2005. The \$169,030 increase in stockholders' equity during first six months of 2006 was primarily due to net income of \$175,619 and the issuance of 294,107 shares of common stock to employees as a result of the exercise of stock options and the vesting of stock awards, offset in part by the repurchase of 1,000,000 shares for \$11,000.

Information regarding purchases of our common stock during the six months ended June 30, 2006 is as follows:

Period	Number of shares	Average Share Price paid	Total number of shares purchased as part of publicly announced plans
May 1 - May 31	1,001,259	\$ 11.00	--

A total of 1,000,000 shares were purchased on May 9, 2006 from a corporation controlled by a member of OCN's Board of Directors at a price of \$11.00 per share. As disclosed in Note 3 to the Interim Consolidated Financial Statements, we also purchased a total of 1,259 fractional shares on May 12, 2006 at a cost of \$11.29 per share in connection with the Reverse/Forward Split. Our ability to repurchase shares of our common stock is restricted under the terms of the Guaranty that we entered into with the OTS in connection with debanking.

### INCOME TAX EXPENSE (BENEFIT)

The following table provides details of our income tax expense (benefit) for the periods indicated:

	Three months	
	2006	2005
For the periods ended June 30,		
Income tax expense (benefit) on income before taxes .....	\$ 3,519	\$

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Provision for (reversal of) valuation allowance on deferred tax assets ...	(145,211)	
Provision for recapture of base year bad debt reserves .....	--	
	-----	-----
Total income tax expense (benefit) .....	\$ (141,692)	\$
	-----	-----

As disclosed in Note 6 to our Interim Consolidated Financial Statements, we reversed \$145,211 of valuation allowances on our deferred tax assets during the second quarter of 2006 in order to increase the net deferred tax asset to the amount that is more likely than not to be realized in future periods. Our determination that it was appropriate to reverse the valuation allowances in the second quarter of 2006 was primarily based on a positive trend in our recent earnings history and a more positive outlook for future earnings.

In the second quarter of 2005, we recorded a one-time provision of \$1,967 (\$1,124 net of a related reversal of the valuation allowance on the deferred tax asset) to recognize a deferred tax liability arising from the recapture of bad debt reserves in connection with our termination of the Bank's status as a federal savings bank.

32

Income tax expense on income before income taxes differs from amounts that would be computed by applying the Federal corporate income tax rate of 35% primarily because of the effect of foreign taxes, foreign income with an indefinite deferral from U.S. taxation, losses from consolidated VIEs, state taxes, low-income housing tax credits and changes in the deferred tax valuation allowance. Excluding the effect of the reversal of valuation allowances on deferred tax assets in the second quarter of 2006, our effective tax rate was 21.73% for the first six months of 2006. Excluding the effect of the one-time provision for the recapture of bad debt reserves in the second quarter of 2005, our effective tax rate was 20.85% for the first six months of 2005. We estimate our effective tax rate based on projected full-year results, and we revise the estimate quarterly during the year.

### LIQUIDITY, COMMITMENTS AND OFF-BALANCE SHEET RISKS

#### Liquidity

Our primary sources of funds for liquidity are:

- o Lines of credit and other secured borrowings
- o Servicing fees
- o Match funded liabilities
- o Payments received on trading securities
- o Debt securities
- o Interest payments on and proceeds from sales of loans

We closely monitor our liquidity position and ongoing funding requirements. At June 30, 2006, we had \$191,919 of unrestricted cash, which represented 12% of total assets. We also had \$202,444 of investment grade securities at June 30, 2006. Total cash and investment grade securities comprised 24% of total assets at June 30, 2006. Under certain of our credit facilities, we are required to maintain minimum liquidity levels. Among the risks and challenges associated with our funding activities are the following:

- o Cash requirements to fund our acquisition of additional servicing rights and related advances and to fund existing operations and growth in other core business lines.
- o The maturity of existing lines of credit and other secured borrowings at

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

various dates through June 2007, subject to the renewals of these agreements. We had an aggregate balance of \$170,876 outstanding under these agreements at June 30, 2006.

Our credit facilities are summarized as follows:

	Maturity -----	Unused Borrowing Capacity -----
Residential Servicing:		
Match funded liability .....	Nov. 2011 - Mar. 2014	\$ 54,743
Match funded liability .....	Jan. 2007	31,294
Secured line of credit .....	Aug. 2006	36,472
		-----
		122,509
		-----
Residential Origination Services:		
Repurchase agreement .....	Jun. 2007	68,178
Repurchase agreement .....	Feb. 2007	2,746
Repurchase agreement .....	Apr. 2036	N/A
Secured line of credit .....	Jun. 2007	21,728
		-----
		92,652
		-----
Corporate Items and Other:		
Mortgage .....	Oct. 2014	--
Convertible Notes .....	Aug. 2024	--
Capital Securities .....	Aug. 2027	--
		-----
		--
		-----
		\$ 215,161
		=====

We grow our Residential Servicing business primarily through the purchase of servicing rights or by entering into subservicing agreements. Servicing rights entitle us as the owner to earn servicing fees and other types of ancillary income, but they also impose on us various obligations as the servicer. Among these are the obligations to advance our own funds to meet contractual principal and interest payments for certain investors and to pay taxes, insurance and various other items that are required to preserve the assets being serviced.

33

Our ability to expand our Residential Servicing business depends in part on our ability to obtain additional financing to purchase new servicing rights and to fund servicing advances. We currently use a variety of sources of debt to finance these assets, including match funded agreements, credit facilities and seller financing. Our credit facilities provide funds to us in amounts that are less than the full value of the related servicing assets that serve as collateral for the credit facilities. If we cannot replace or renew these sources as they mature or obtain additional sources of financing, we may be unable to acquire new servicing rights or make the associated advances.

We believe that our existing sources of liquidity, including internally

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

generated funds, will be adequate to fund planned activities, although there can be no assurances in this regard. At June 30, 2006, we had \$215,161 of unused stated borrowing capacity under existing credit agreements. We continue to evaluate other sources of liquidity, such as debt securities, lines of credit from unaffiliated parties, match funded debt and other secured borrowings. We are examining all of our asset classes to identify additional funding opportunities. This includes receivables, the balance of which amounted to \$60,738 at June 30, 2006. We are also examining opportunities to obtain additional funding on loans held for resale during the holding period and to increase financing on our servicing rights and advances.

Our operating activities provided \$480,392 and \$152,702 of cash flows during the six months ended June 30, 2006 and 2005, respectively. The increase in net cash flows provided by operating activities primarily reflects a significant decline in loans held for resale as a result of sales and securitizations during the first six months of 2006. During the first six months of 2006, proceeds from sales and securitizations of loans held for resale exceeded purchases and originations during the period by \$458,895. Also, \$48,630 of principal payments were received on loans held for resale during the first six months of 2006. During the first six months of 2005 purchases and originations exceeded sales and securitizations by \$6,279. Although net income for 2006 increased by \$170,324, it includes a tax benefit of \$136,767 primarily reflecting the reversal of \$145,211 of deferred tax asset valuation allowances, a non-cash item.

Our investing activities used cash flows totaling \$52,666 and \$52,719 during the six months ended June 30, 2006 and 2005, respectively. Although purchases of premises and equipment declined in the first six months of 2006 as compared to the same period in 2005, the impact on cash flow was largely offset by the effect on 2005 cash flow of the cash received from the sale of a subsidiary.

Our financing activities used cash flows of \$504,208 and \$332,641 during the six months ended June 30, 2006 and 2005, respectively. Cash flows used by financing activities in the first six months of 2006 primarily reflect a net decrease in collateralized borrowing agreements used to finance loans held for resale. Net repayments of lines of credit and other secured borrowings amounted to \$465,296 during the first six months of 2006 as compared to net proceeds from borrowings of \$1,913 for the same periods of 2005. Cash flows used by financing activities during the first six months of 2005 primarily reflect a decline in deposits as a result of maturing certificates of deposit prior to debanking and the cash payment to Marathon in connection with their assumption of our customer deposits on June 30, 2005.

### Commitments

We believe that we have adequate resources to fund all unfunded commitments to the extent required and meet all contractual obligations as they come due. Such contractual obligations include our Convertible Notes, Capital Trust Securities, lines of credit and other secured borrowings and operating leases. See Note 9 to the Interim Consolidated Financial Statements for additional information regarding commitments and contingencies.

### Off-Balance Sheet Risks

As of June 30, 2006 we had outstanding commitments to fund mortgage loans of \$52,764 and outstanding commitments to sell \$22,293 of our loans held for resale.

In addition to commitments to extend credit, we are party to various off-balance sheet financial instruments in the normal course of our business to manage our interest rate risk and foreign currency exchange rate risk. We have

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

also committed to fund operating cash deficits of certain affordable housing properties that we have sold.

We conduct business with a variety of financial institutions and other companies in the normal course of business, including counterparties to our off-balance sheet financial instruments. We are subject to potential financial loss if the counterparty is unable to complete an agreed upon transaction. We seek to limit counterparty risk through financial analysis, dollar limits and other monitoring procedures.

### RECENT ACCOUNTING DEVELOPMENTS

During the first quarter of 2006, we adopted SFAS No. 123(R), "Share-Based Payment", however it did not have a material effect on our consolidated financial statements. For additional information regarding recent accounting pronouncements, see Note 2 to the Interim Consolidated Financial Statements.

34

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

Market risk includes interest rate risk, foreign currency exchange rate risk and liquidity risk. We are exposed to interest rate risk to the degree that our interest-bearing liabilities mature or reprice at different speeds, or different bases, than our interest-earning assets. We are exposed to foreign currency exchange rate risk in connection with our investment in non-U.S. dollar functional currency operations and to the extent our foreign exchange positions remain unhedged. Market risk also reflects the risk of declines in the valuation of trading securities, mortgage servicing rights and in the value of the collateral underlying loans.

We are also exposed to liquidity risk primarily because of the highly variable daily cash requirements to support the Residential Servicing business including acquisitions of mortgage servicing rights, the requirement to make advances pursuant to servicing contracts and the process of remitting borrower payments to the custodial accounts. In general, we finance our operations through operating cash flows and various other sources including long-term debt and financing facilities. See "Liquidity, Commitments and Off-Balance Sheet Risks" for additional discussion regarding liquidity.

The primary risk associated with mortgage servicing rights is that they will lose a portion of their value as a result of higher than anticipated prepayments occasioned by declining interest rates or because of higher than anticipated delinquency rates occasioned by deteriorating credit conditions. Interest rates, prepayment speeds and the payment performance of the underlying loans significantly affect both our initial and ongoing valuations and the rate of amortization of mortgage servicing rights. As of June 30, 2006, the carrying value and estimated fair value of our residential mortgage servicing rights were \$149,498 and \$220,476, respectively.

Our Residential Servicing business is characterized by non-interest earning assets financed by interest-bearing liabilities. Among the more significant non-interest earning assets are servicing advances and mortgage servicing rights. At June 30, 2006, we had residential servicing advances of \$610,852 consisting of advances on loans serviced for others of \$258,989 and match funded advances on loans serviced for others of \$351,593.

We are also exposed to interest rate risk because earnings on our residential servicing float balances are affected by short-term interest rates. These float balances, which are not included in our financial statements,

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

amounted to \$671,579 at June 30, 2006. We report these earnings as a component of servicing and subservicing fees.

At June 30, 2006, the combined balance of our match funded liabilities, debt securities, lines of credit and other secured borrowings totaled \$652,127. Of this amount \$487,317 was variable rate debt, for which debt service costs are sensitive to changes in interest rates, and \$164,810 was fixed rate debt.

Our balance sheet at June 30, 2006 included interest-earning assets totaling \$425,715, including \$114,485 of loans held for resale.

### Impact of Changes in Interest Rates on the Net Value of Interest Rate-Sensitive Financial Instruments

We perform an interest rate sensitivity analysis of our mortgage servicing rights portfolio every quarter. We currently estimate that the fair value of the portfolio increases or decreases by approximately 2% for every 50 basis point (bp) increase or decrease in interest rates. This sensitivity analysis is limited in that it was performed at a particular point in time; only contemplates certain movements in interest rates; does not incorporate changes in interest rate volatility; is subject to the accuracy of various assumptions used, including prepayment forecasts and discount rates; and does not incorporate other factors that would impact our overall financial performance in such scenarios. We carry mortgage servicing rights at the lower of amortized cost or fair value by strata. To the extent that fair value were to decline below amortized cost, we would record an impairment charge to earnings and establish a valuation allowance. A subsequent increase in fair value could result in the recovery of some or all of a previously established valuation allowance. However, an increase in fair value of a particular stratum above its amortized cost would not be reflected in current earnings. For these reasons, this interest rate sensitivity estimate should not be viewed as an earnings forecast.

Our Investment Management Committee is authorized to utilize a wide variety of off-balance sheet financial techniques to assist it in the management of interest rate risk and foreign currency exchange rate risk. These techniques include interest rate exchange contracts or "swap" agreements, interest rate caps and floors, U.S. Treasury interest rate futures contracts, Eurodollar futures contracts, foreign currency futures contracts, foreign currency forwards and European swaptions and put options.

We have entered into foreign currency futures to hedge our net investment in the foreign subsidiary that owns our UK subprime residual securities. The notional amount of these futures was (pound)12,875 (\$23,796) at June 30, 2006. Our principal exposure to foreign currency exchange rates exists with the British Pound versus the U.S. dollar. Our operations in India and the foreign operations of GSS and BOK also expose us to foreign currency exchange rate risk. However, this risk is insignificant.

We have also entered into Eurodollar interest rate futures to hedge our exposure to interest rate risk represented by our loans held for resale prior to their sale or securitization. The notional amount of these futures was \$1,154,000 at June 30, 2006.

35

#### ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities



## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Exchange Act) as of June 30, 2006. Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of June 30, 2006 our disclosure controls and procedures (1) were designed to ensure that material information relating to OCN, including its consolidated subsidiaries, is made known to our chief executive officer and chief financial officer by others within those entities, particularly during the period in which this report was being prepared and (2) were operating effectively, in that they provide reasonable assurance that information required to be disclosed by OCN in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) occurred during the fiscal quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS.

See "Note 9 Commitments and Contingencies" of the Interim Consolidated Financial Statements for information regarding legal proceedings.

#### ITEM 1A. RISK FACTORS

See our discussion of risk factors on page 17 of "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

At our Annual Meeting of Shareholders held on May 4, 2006, the following individuals were elected to the Board of Directors of OCN:

	Votes For	Votes Withheld
William C. Erbey.....	55,496,275	335,945
Ronald M. Faris.....	55,448,845	383,375
Martha C. Goss.....	55,534,441	297,779
Ronald J. Korn.....	55,534,441	297,779
William H. Lacy.....	55,534,541	297,679
W. Michael Linn.....	53,498,694	2,333,526
W.C. Martin.....	55,533,541	298,679
Barry N. Wish.....	53,491,386	2,340,834

Additionally, amendments to our Amended and Restated Articles of Incorporation to provide for a one-for-ten (1-for-10) reverse stock split immediately followed by a ten-for-one (10-for-1) forward stock split of the issued and outstanding shares of our common stock was voted on and approved by the shareholders as follows:

Votes for.....	49,297,560
Votes against.....	10,604
Abstentions.....	11,444

Ratification of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending December 31, 2006 was also voted on and approved by the shareholders as follows:

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Votes for.....	55,812,466
Votes against.....	11,127
Abstentions.....	8,627

36

### ITEM 6. EXHIBITS

- (3) Exhibits. (Exhibits marked with a " \* " denote management contracts or compensatory plans or agreements)
- 2.1 Agreement of Merger dated as of July 25, 1999 among Ocwen Financial Corporation, Ocwen Asset Investment Corp. and Ocwen Acquisition Company (1)
  - 2.2 Stock Purchase Agreement dated as of May 23, 2006 by and among Bankruptcy Management Solutions, Inc., Its Stockholders and Warrant Holder, and BMS Holdings, Inc. (filed herewith)
  - 2.3 Amendment No. 1 dated July 31, 2006 to the Stock Purchase Agreement by and among Bankruptcy Management Solutions, Inc., Its Stockholders and Warrant Holder, and BMS Holdings, Inc. (filed herewith). The company agrees to furnish supplementally a copy of any omitted schedule to the Commission upon request.
  - 3.1 Amended and Restated Articles of Incorporation (2)
  - 3.2 Amended and Restated Bylaws (3)
  - 4.0 Form of Certificate of Common Stock (2)
  - 4.1 Certificate of Trust of Ocwen Capital Trust I (4)
  - 4.2 Amended and Restated Declaration of Trust of Ocwen Capital Trust I (4)
  - 4.3 Form of Capital Security of Ocwen Capital Trust I (included in Exhibit 4.4) (4)
  - 4.4 Form of Indenture relating to 10.875% Junior Subordinated Debentures due 2027 of OCN (4)
  - 4.5 Form of 10.875% Junior Subordinated Debentures due 2027 of OCN (included in Exhibit 4.6) (4)
  - 4.6 Form of Guarantee of OCN relating to the Capital Securities of Ocwen Capital Trust I (4)
  - 4.7 Registration Rights Agreement dated as of July 28, 2004, between OCN and Jeffries & Company Inc. (5)
  - 4.8 Indenture dated as of July 28, 2004, between OCN and the Bank of New York Trust Company, N.A., as trustee (5)
  - 10.1\* Ocwen Financial Corporation 1996 Stock Plan for Directors, as amended (6)
  - 10.2\* Ocwen Financial Corporation 1998 Annual Incentive Plan (7)
  - 10.3 Compensation and Indemnification Agreement, dated as of May 6, 1999, between OAC and the independent committee of the Board of Directors (8)
  - 10.4 Indemnity agreement, dated August 24, 1999, among OCN and OAC's directors (9)
  - 10.5\* Amended Ocwen Financial Corporation 1991 Non-Qualified Stock Option Plan, dated October 26, 1999 (9)
  - 10.6 First Amendment to Agreement, dated March 30, 2000 between HCT Investments, Inc. and OAIC Partnership I, LP (9)
  - 10.7\* Ocwen Financial Corporation Deferral Plan for Directors, dated March 7, 2005 (10)
  - 10.8 Collateral Trust Agreement, dated June 28, 2005, between OCN and the Bank of New York Trust Company, N.A. (11)
  - 10.9 Guaranty, dated June 28, 2005, from OCN to the Guaranteed Parties (11)

## Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

- 10.10 Cash Collateral Agreement, dated June 28, 2005, among OCN, Bank of New York Trust Company, N.A. as collateral Trustee and Bank of New York Trust Company, N.A. as Account Bank (11)
- 10.11 Stock Purchase Agreement, dated May 5, 2006, between Wishco, Inc. and OCN (12)
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
- (1) Incorporated by reference from a similarly described exhibit included with the Registrant's Current Report on Form 8-K filed with the Commission on July 26, 1999.
- (2) Incorporated by reference from the similarly described exhibit filed in connection with the Registrant's Registration Statement on Form S-1 (File No. 333-5153) as amended, declared effective by the commission on September 25, 1996.
- (3) Incorporated by reference from the similarly described exhibit included with the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998.
- (4) Incorporated by reference from the similarly described exhibit filed in connection with our Registration Statement on Form S-1 (File No. 333-28889), as amended, declared effective by the Commission on August 6, 1997.
- (5) Incorporated by reference from the similarly described exhibit included with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004.
- (6) Incorporated by reference from the similarly described exhibit filed in connection with the Registrant's Registration Statement on Form S-8 (File No. 333-44999), effective when filed with the Commission on January 28, 1998.
- (7) Incorporated by reference from the similarly described exhibit to our definitive Proxy Statement with respect to our 1998 Annual Meeting of Shareholders as filed with the Commission on March 31, 1998.
- (8) Incorporated by reference from OAC's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999.
- (9) Incorporated by reference from the similarly described exhibit included with the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000.
- (10) Incorporated by reference from the similarly described exhibit included with the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004.
- (11) Incorporated by reference from the similarly described exhibit included with the Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005.
- (12) Incorporated by reference from the similarly described exhibit included with the Registrant's Form 8-K filed with the Commission on May 11, 2006.

Edgar Filing: OCWEN FINANCIAL CORP - Form 10-Q

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OCWEN FINANCIAL CORPORATION

By: /s/ DAVID J. GUNTER

-----  
David J. Gunter, Senior Vice President  
& Chief Financial Officer  
(On behalf of the Registrant and as  
its principal financial officer)

Date: August 9, 2006