ACCREDITED HOME LENDERS HOLDING CO
Form SC 14D9
June 19, 2007
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14D-9

SOLICITATION/RECOMMENDATION STATEMENT UNDER

SECTION 14(d)(4) OF THE SECURITIES EXCHANGE ACT OF 1934

Accredited Home Lenders Holding Co.

(Name of Subject Company)

Accredited Home Lenders Holding Co.

(Name of Persons Filing Statement)

Common Stock, Par Value $0.001 per share

(Title of Class of Securities)

00437P107

(CUSIP Number of Class of Securities)

James A. Konrath

Chief Executive Officer and Chairman of the Board

15253 Avenue of Science

San Diego, California 92128

858-676-2100

(Name, address and telephone numbers of person authorized to receive notice and

communications on behalf of the persons filing statement)

Copies to:

Aileen C. Meehan

David M. Smith

Dewey Ballantine LLP

1301 Avenue of the Americas

New York, New York 10019

(212) 259-8000

¨ Check the box if the filing relates solely to preliminary communications made before the commencement of a tender offer.

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Item 1. ***Subject Company Information***

(a) *Name and Address.* The name of the subject company is Accredited Home Lenders Holding Co., a Delaware corporation (Accredited or the Company). The address of the principal executive offices of the Company is 15253 Avenue of Science, San Diego, California 92128, and the Company s telephone number is (858) 676-2100.

(b) *Securities.* The title of the class of equity securities to which this Solicitation/Recommendation Statement on Schedule 14D-9 (together with the exhibits and annexes, this Schedule) relates is the common stock, par value $0.001 per share, of the Company (the Common Stock). As of the close of business on May 31, 2007, there were 25,122,152 shares of Common Stock issued and outstanding.

Item 2. ***Identity and Background of Filing Person***

(a) *Name and Address.* The filing person is the subject Company. The name, business address and business telephone number of the Company are set forth in Item 1(a) above.

(d) *Tender Offer.* This Schedule relates to a tender offer by LSF5 Accredited Merger Co., Inc., a Delaware corporation (Offeror), disclosed in a Tender Offer Statement on Schedule TO, dated June 19, 2007 (as amended or supplemented from time to time, the Schedule TO), to purchase all of the issued and outstanding shares of Common Stock at a purchase price of $15.10 per share (the Offer Price), net to the seller in cash (subject to applicable withholding tax), without interest, upon the terms and subject to the conditions set forth in the Offer to Purchase, dated June 19, 2007 (as amended or supplemented from time to time, the Offer to Purchase), and the related Letter of Transmittal (the Letter of Transmittal). The consideration offered per share, together with all the terms and conditions of the Offeror s tender offer, as set forth in the Offer to Purchase and the Letter of Transmittal, as they may be amended from time to time, is referred to in this Schedule as the Offer. Offeror is a wholly-owned subsidiary of LSF5 Accredited Investments LLC, a Delaware limited liability company (Parent). The Offer to Purchase and the Letter of Transmittal are filed as Exhibits (a)(1)(A) and (a)(1)(B) hereto, respectively, and are incorporated herein by reference.

The Offer is being made pursuant to an Agreement and Plan of Merger, dated as of June 4, 2007 (as amended by the First Amendment dated as of June 15, 2007 (the First Amendment), and as subsequently amended or supplemented from time to time, the Merger Agreement), among Parent, Offeror and the Company. Offeror s obligation to purchase shares of Common Stock tendered in the Offer is subject to the valid tender of shares of Common Stock, considered together with all other shares of Common Stock (if any) beneficially owned by Parent and its Affiliates (as defined in the Merger Agreement), representing more than 50% of the Company Outstanding Shares (as defined in the Merger Agreement), (the Minimum Condition). The Merger Agreement provides, among other things, for the making of the Offer and further provides that following the consummation of the Offer and subject to the satisfaction or waiver of the conditions set forth in the Merger Agreement and in accordance with the Delaware General Corporation Law (the DGCL), Offeror will merge with and into the Company (the Merger) and the Company will continue as the surviving corporation (the Surviving Corporation), a wholly-owned subsidiary of Parent. At the effective time of the Merger (the Merger Effective Time), each share of Common Stock (other than shares of Common Stock owned by Offeror, Parent, the Company or any of their respective subsidiaries and shares of Common Stock held by stockholders who are entitled to and who have properly demanded and perfected appraisal rights under the DGCL) that is not tendered pursuant to the Offer will be converted into the right to receive cash in the amount equal to the Offer Price and all shares of Common Stock will cease to be outstanding, will automatically be cancelled and will cease to exist. A copy of the Merger Agreement, which has been filed as Exhibit (e)(1)(A) hereto, and the First Amendment, which has been filed as Exhibit (e)(1)(B) hereto, are incorporated herein by reference.

The initial expiration date for the Offer is 12:00 Midnight, New York City time, on July 17, 2007, subject to extension in certain circumstances as required or permitted by the Merger Agreement and applicable law. Due to

the need to obtain certain regulatory approvals prior to the consummation of the Offer, the Company and Offeror currently expect that the Offer will be extended beyond the scheduled expiration date at least one or more times. *Please see Additional Information Regulatory Approvals* .

As set forth in the Schedule TO, the address of the principal executive office of Parent and Offeror is 717 North Harwood Street, Suite 2200, Dallas, Texas 75201, telephone number (214) 754-8430.

Item 3. ***Past Contacts, Transactions, Negotiations and Agreements***
Conflicts of Interest

Except as set forth in this Item 3, or in the Information Statement of the Company attached to this Schedule as Annex I (the Information Statement) or as incorporated by reference herein, as of the date hereof, there are no material agreements, arrangements or understandings or any actual or potential conflicts of interest between the Company or its affiliates and (i) any of the Company s executive officers, directors or affiliates, or (ii) any of Parent, Offeror or any of their respective executive officers, directors or affiliates. The Information Statement is being furnished to the Company s stockholders pursuant to Section 14(f) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Rule 14f-1 promulgated under the Exchange Act, in connection with Offeror s right (after acquiring a majority of the Company Outstanding Shares pursuant to the Offer) to designate persons to the Board of Directors of the Company (the Board) other than at a meeting of the stockholders of the Company. The Information Statement is incorporated herein by reference.

(a) The Subject Company, its Executive Officers, Directors or Affiliates
The following is a discussion of all known material agreements, arrangements, understandings and any actual or potential conflicts of interest between the Company and its affiliates that relate to the Offer. Additional material agreements, arrangements, understandings and actual or potential conflicts of interest between the Company and its affiliates that are unrelated to the Offer are discussed in the Information Statement.

Interests of Certain Persons

Certain members of management and the Board may be deemed to have certain interests in the transactions contemplated by the Merger Agreement that are different from or in addition to the interests of the Company s stockholders generally. The Board was aware of these interests and considered that such interests may be different from or in addition to the interests of the Company s stockholders generally, among other matters, in approving the Merger Agreement and the transactions contemplated thereby. As described below, consummation of the Offer may result in certain payments being made to the officers and directors of the Company which may not occur if a consummation does not take place.

Accelerated Vesting and Cashout of Restricted Stock and Option Agreements

The Merger Agreement provides that: (i) each outstanding restricted share shall vest upon the consummation of the Merger and be immediately exchanged for a cash payment equal to the Merger Consideration (as defined in the Merger Agreement), less any applicable withholding taxes and without interest (ii) each outstanding restricted stock unit granted outside of the Company s Deferred Compensation Plan (as defined in the First Amendment) shall, upon the consummation of the Merger, vest and be immediately exchanged for a cash payment equal to the Merger Consideration in respect of each share of Common Stock underlying such restricted units, less any applicable withholding taxes and without interest; and (iii) each option to purchase Company Stock currently outstanding shall immediately vest upon the consummation of the Merger and be immediately exchanged for a cash payment equal to the difference between the exercise price of such option and the Merger Consideration, less any applicable withholding taxes and without interest.

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In addition, the Merger Agreement provides that each outstanding restricted stock unit granted under the Company s Deferred Compensation Plan, whether vested or unvested, will be exchanged upon consummation of the Merger for an amount in cash equal to the Merger Consideration, and such cash amounts will be deposited in the trust maintained for purposes of funding the Deferred Compensation Plan, and the vesting and distribution of such cash amounts and any subsequent earnings thereon will continue to be determined in accordance with the terms of the Deferred Compensation Plan. Amounts held in the trust which are attributable to Company contributions (including amounts exchanged for restricted stock units) will become vested if a participant s employment is terminated without cause or the participant resigns for good reason within one year of a change in control (as defined in the Deferred Compensation Plan). The parties to the Merger Agreement have agreed that, prior to the first acceptance by Offeror for payment of any shares of Common Stock tendered pursuant to the Offer (the Acceptance Time), the Deferred Compensation Plan will be amended such that any participant who is a non-employee member of the Company s board of directors shall become fully vested in all Company contributions in the event that such participant (i) resigns at the request of the Company from the Company s board of directors in contemplation of a change of control (which would include the Merger) following the Company entering into a definitive transaction agreement, the consummation of which would result in a change of control or (ii) resigns or is removed from the Company s board of directors within one year after a change of control.

As described below (see *New Management Arrangements*), certain members of management may be given the opportunity, as an alternative to the cash payment in respect of their restricted shares or options described above, to exchange such restricted shares or options for equity interests in the Offeror or, at Parent s discretion, Parent or another affiliate of Parent, upon terms to be determined by such members of management and Offeror or Parent, as the case may be.

	Cash-Out of Stock Options[1]		**Restricted Stock[2]**	**Restricted Stock Units[3]**	
Executive Officers/Directors	**Previously Vested Options**	**Accelerated Options**	**Accelerated (in thousands)**	**Vested**	**Potentially Accelerated**
James A. Konrath Chairman and CEO				9,666	28,780
Joseph Lydon President and COO	0	0		17,961	28,797
Stuart D. Marvin Executive VP and Secretary			21,360	0	5,402
Jeffrey W. Crawford Director of Operations	4,083	0		11,751	18,682
David Hertzel General Counsel	18,500	0		1,852	4,837
John Buchanan CFO	10,000	0		2,394	4,447
James H. Berglund	17,500	0		4,631	5,344
Gary M. Erickson	17,500	0		2,460	5,344
Bowers W. Espy	0	0		0	3,917
Jody A. Gunderson	51,000	0		2,460	5,344
A. Jay Meyerson	0	17,500			
Richard T. Pratt	17,500	0		2,460	5,344
Stephen E. Wall					

1 Pursuant to the Merger Agreement, all Company stock options outstanding will, at the time the Merger is consummated, become fully vested, and each stock option will be cancelled and exchanged for the right to receive an amount of cash determined by multiplying (x) the excess of the Merger Consideration over the applicable exercise price per share of such stock option by (y) the number of shares of Common Stock subject to such stock option (less any applicable withholding taxes and without interest). Amounts shown in the Previously Vested Options column reflect stock options vested as of June 18, 2007.

2 Pursuant to the Merger Agreement, all restricted shares of Common Stock will, at the time the Merger is consummated, become fully vested, and each share will be exchanged for the right to receive an amount of cash determined by multiplying (x) the Merger Consideration by (y) the number of shares of Common Stock owned (less any applicable withholding taxes and without interest). There is no Previously Vested column for restricted shares of Common Stock because restricted shares that vest are no longer considered restricted shares.

3 Under the terms of the Merger, restricted stock units (vested or unvested) under the Deferred Compensation Plan shall be exchanged for (x) the Merger Consideration multiplied by (y) the number of shares of Common Stock underlying the respective participant s restricted

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stock units. This cash amount will then be held in trust under the Deferred Compensation Plan, and such cash amount and any subsequent earnings thereon will vest and be distributed under the terms of the Deferred Compensation Plan. Pursuant to the terms of the Deferred Compensation Plan, Company contributions (including amounts exchanged for restricted stock units) held in the Deferred Compensation Plan will become 100% vested if a participant s employment is terminated without cause or the participant resigns for good reason within one year of the Merger. The parties to the Merger Agreement have agreed that, prior to the Acceptance Time, the Deferred Compensation Plan will be amended such that any participant who is a non-employee member of the Company s board of directors shall become fully vested in all Company contributions in the event that such participant (i) resigns at the request of the Company from the Company s board of directors in contemplation of a change in control (which would include the purchase of shares of Common Stock at the Acceptance Time and would also include the Merger) following the Company entering into a definitive transaction agreement, the consummation of which would result in a change of control or (ii) resigns or is removed from the Company s board of directors within one year after a change of control. Amounts shown in the Potentially Accelerated column represent the number of unvested restricted stock units that will be exchanged for Merger Consideration and placed in trust under the Deferred Compensation Plan. Amounts shown in the Vested column reflect restricted stock units vested as of June 18, 2007 that will be exchanged for Merger Consideration and placed in trust under the Deferred Compensation Plan.

New Management Arrangements

Certain members of management may be given the opportunity, prior to the Merger Effective Time, to exchange some or all of their Company restricted shares, shares of Common Stock or Company stock options, as applicable, for equity interests in Offeror, or, at Parent s discretion, Parent or one of Parent s affiliates that would represent, in the aggregate, after the Merger Effective Time, a direct or indirect interest in the Company equivalent to 3% to 7% of the outstanding capital stock of the Company on a fully-diluted basis. Neither Offeror nor Parent currently has any agreement or understanding with any member of management with respect to the aforementioned exchanges. In addition, Parent and Offeror have indicated their desire that the current management team will continue to manage the Company after the Offer and the Merger, if such transactions are consummated. However, such matters are subject to negotiation and discussion, and neither Parent, Offeror nor any of their affiliates has entered into any employment agreement with any member of management, nor has any understanding been reached with regard to the compensation of any member of management following the Offer and the Merger. By virtue of these potential arrangements, members of management may have an opportunity to participate in the growth of the Surviving Corporation after the Merger which will not be available to the other stockholders of the Company.

Indemnification of Executive Officers and Directors

The Merger Agreement

The Merger Agreement contains provisions relating to the indemnification of and insurance for the Company s and the Company s subsidiaries directors, officers, trustees, employees, agents and fiduciaries. Under the terms of the Merger Agreement, and without limiting any additional rights that any director, officer, trustee, employee, agent, or fiduciary may have under any employment or indemnification agreement or under the Company s certificate of incorporation, the Company s bylaws or the Merger Agreement or, if applicable, similar organizational documents or agreements of any of the Company s subsidiaries, from and after the Merger Effective Time, the Surviving Corporation will: (i) indemnify and hold harmless each person who is at the date of the execution of the Merger Agreement or during the period from the date thereof through the Closing Date serving as a director, officer, trustee, employee, agent, or fiduciary of the Company or Company Subsidiaries (as defined in the Merger Agreement) or as a fiduciary under or with respect to any employee benefit plan (within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (ERISA)) (individually the Indemnified Party and collectively, the Indemnified Parties) to the fullest extent authorized or permitted by applicable Law (as defined in the Merger Agreement), as now or hereafter in effect, in connection with any Claim (as defined in the Merger Agreement) and any judgments, fines, penalties and amounts paid in settlement (including all interest, assessments and other charges paid or payable in connection with or in respect of such judgments, fines, penalties or amounts paid in settlement) resulting therefrom with respect to any employee benefit plan (within the meaning of Section 3(3) of ERISA); and (ii) promptly pay on behalf of or, within 30 days after any request for advancement, advance to each of the Indemnified Parties, to the fullest extent authorized or permitted by applicable Law, as now or hereafter in effect, any Expenses (as defined in the Merger Agreement) incurred in defending, serving as a witness with respect to or otherwise participating in

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any Claim in advance of the final disposition of such Claim, including payment on behalf of or advancement to the Indemnified Party of any Expenses incurred by such Indemnified Party in connection with enforcing any rights with respect to such indemnification or advancement, in each case without the requirement of any bond or other security.

The indemnification and advancement obligations of Parent and the Surviving Corporation pursuant to the Merger Agreement will extend to acts or omissions occurring at or before the Merger Effective Time and any Claim relating thereto (including with respect to any acts or omissions occurring in connection with the approval of the Merger Agreement and the consummation of the transactions contemplated thereby, including the consideration and approval thereof and the process undertaken in connection therewith and any Claim relating thereto), and all rights to indemnification and advancement conferred thereunder will continue as to a person who continues to be or who has ceased to be a director, officer, trustee, employee, agent, or fiduciary of the Company or the Company Subsidiaries after the date thereof and will inure to the benefit of such person s heirs, executors and personal and legal representatives. Neither Parent nor the Surviving Corporation will settle, compromise or consent to the entry of any judgment in any actual or threatened claim, demand, Action (as defined in the Merger Agreement), suit, proceeding, inquiry or investigation in respect of which indemnification has been or could be sought by such Indemnified Party thereunder unless such settlement, compromise or judgment includes an unconditional release of such Indemnified Party from all liability arising out of such claim, demand, Action, suit, proceeding, inquiry or investigation or such Indemnified Party otherwise consents thereto.

Pursuant to the Merger Agreement, the parties agreed that all rights to indemnification and exculpation from liabilities for acts or omissions occurring at or prior to the Merger Effective Time existing in favor of current or former directors, officers, trustees, employees, agents, or fiduciaries of the Company or its subsidiaries as provided in the Company s certificate of incorporation and bylaws, or in the organizational documents of any Company Subsidiary, as applicable, as well as in indemnification agreements of the Company or any of the Company Subsidiaries including, without limitation, indemnification agreements with directors and officers (described below), will be assumed by the Surviving Corporation in the Merger and will survive the Merger and continue in full force and effect in accordance with their terms.

For a period of six years following the Merger Effective Time, the organizational documents of the Surviving Corporation will contain provisions no less favorable with respect to indemnification than are set forth in the organizational documents of the Company immediately prior to the Merger Effective Time, which provisions will not be amended, repealed or otherwise modified for a period of six years from the Merger Effective Time in any manner that would affect adversely the rights thereunder of the parties indemnified thereunder, unless such modification will be required by Law (as defined in the Merger Agreement) and then only to the minimum extent required by Law.

Indemnity Agreements

The Company previously entered into indemnity agreements (Indemnity Agreements) with directors and officers (each an Indemnitee) of the Company pursuant to which the Company agreed to indemnify and assume for itself maximum liability for expenses and damages in connection with claims against such directors and officers in connection with their service to the Company and the Company Subsidiaries. The Company agreed to indemnify the Indemnitee for (i) all expenses incurred in the Indemnitee s successful defense of any proceeding to which the Indemnitee was a party by reason of the fact that the Indemnitee was an agent of the Company at any time, (ii) all expenses and liabilities of any type whatsoever, in connection with a proceeding in which the Indemnitee is, or is threatened to be made, a party by reason of the fact that the Indemnitee was an agent of the Company at any time; (iii) all expenses in connection with the investigation, defense settlement, or appeal of any derivative action which the Indemnitee is a party by reason of the fact that the Indemnitee was an agent of the Company, or by reason of anything done or not done by the Indemnitee in such capacity. For purposes of the Indemnity Agreements, expenses is defined to include all out-of-pocket costs actually and reasonably incurred by the Indemnitee in connection with either the investigation, defense or appeal of a proceeding or establishing or enforcing a right to indemnification under the applicable Indemnity Agreement or

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applicable law; provided that expenses do not include any judgments, fines, excise taxes or penalties, or amounts paid in settlement of a proceeding. The Indemnity Agreements also provide that the Company shall not be obligated (i) to indemnify or advance expenses with respect to claims initiated by the Indemnitee, unless (a) such indemnification is expressly required to be made by law, (b) the proceeding was authorized by the Board, (c) such indemnification is provided by the Company, in its sole discretion, pursuant to the powers vested in the Company under the DGCL, or (d) the proceeding is brought to establish a right to indemnification under the applicable Indemnity Agreement or any other applicable statute or law; (ii) to indemnify for any expenses incurred to enforce or interpret the applicable Indemnity Agreement, if a court determines the material assertions were not made in good faith or were frivolous; or (iii) to indemnify for any amounts paid in settlement of a proceeding unless the Company consents to such settlement, which consent shall not be unreasonably withheld.

Directors and Officers Insurance

The Merger Agreement provides that the Surviving Corporation shall acquire and maintain for a period of at least six years a tail policy of directors and officers liability insurance for events that occur on or prior to the Merger Effective Time, providing substantially equivalent coverages to the current policy covering such persons, except that the Surviving Corporation may substitute therefor policies of at least the same coverage and amounts containing terms and conditions that are, in the aggregate, no less advantageous to the insured, subject to the limitation that the Surviving Corporation shall not be obligated to pay an annual premium in excess of 250% over the current annual premiums paid by the Company for such insurance. In the event that the Surviving Corporation would be required to expend more than 250% of the current annual premiums paid by the Company, the Surviving Corporation will obtain the maximum amount of such insurance obtainable by payment of annual premiums equal to 250% of the current annual premiums paid by the Company and will cause the Surviving Corporation or its successors or assigns to maintain such policies in full force and effect, and continue to honor all obligations thereunder.

The Indemnified Parties are granted third party rights to the benefits of the Surviving Corporation s director and officer insurance covenants and such covenants shall be binding on all successors and assigns of the Company, Parent and the Surviving Corporation.

The foregoing summary of the indemnification of executive officers and directors and Directors and Officers Insurance does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1)(A) hereto, and the First Amendment, which has been filed as Exhibit (e)(1)(B) hereto, and which are incorporated herein by reference.

(b) The Offeror, its Executive Officers, Directors or Affiliates

The following is a discussion of all known material agreements, understandings and any actual or potential conflicts of interest between the Company and Offeror or Parent relating to the Offer. Additional material agreements, understandings and actual or potential conflicts of interest between the Company and its affiliates that are unrelated to the Offer are discussed in the Information Statement.

The Merger Agreement

The summary of the Merger Agreement and the descriptions of the terms and conditions of the Offer and related procedures and withdrawal rights contained in the Offer, which is being filed as an exhibit to the Schedule TO, are incorporated in this Schedule by reference. Such summary and description are qualified in their entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1)(A) to this Schedule and is incorporated herein by reference.

The Merger Agreement governs the contractual rights among the Company, Parent and Offeror in relation to the Offer and the Merger. The Merger Agreement has been filed as an exhibit to this Schedule to provide you with information regarding the terms of the Merger Agreement and is not intended to modify or supplement any

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factual disclosures about the Company in the Company s public reports filed with the United States Securities and Exchange Commission (the SEC). In particular, the Merger Agreement and this summary of terms are not intended to be, and should not be relied upon as, disclosures regarding any facts or circumstances relating to the Company. The representations and warranties have been negotiated with the principal purpose of establishing the circumstances in which Offeror may have the right not to consummate the Offer, or a party may have the right to terminate the Merger Agreement, if the representations and warranties of the other party prove to be untrue due to a change in circumstance or otherwise, and allocate risk between the parties, rather than establish matters as facts. The representations and warranties may also be subject to a contractual standard of materiality different from those generally applicable to stockholders.

The Confidentiality Agreements

The following summary of the Confidentiality Agreements does not purport to be complete and is qualified in its entirety by reference to the Confidentiality Agreement, which has been filed as Exhibit (e)(2) hereto, and is incorporated herein by reference.

In connection with the process leading to the execution of the Merger Agreement, the Company and Lone Star U.S. Acquisitions, LLC (Lone Star) entered into a Confidentiality Agreement dated as of March 24, 2007 (the Confidentiality Agreement). Pursuant to the Confidentiality Agreement, as a condition to being furnished confidential information by the Company, Lone Star agreed, among other things, to use such confidential information solely for the purpose of evaluating a transaction between the Company and Lone Star and, for a period of eighteen months from the date of the agreement, not to: acquire any voting securities of the Company; propose to enter into any tender or exchange offer involving the Company; advise or seek to influence the policies of the Company or the voting of the Company s securities; form or join any group in connection with the foregoing; disclose an intention or plan inconsistent with the foregoing, request to waive or amend any provision of the Confidentiality Agreement, if such waiver would require public disclosure: or enter into any discussions arrangements or understandings or otherwise assist any other person with respect to the foregoing. Lone Star also agreed not to employ or solicit for employment any Company employee, subject to certain exceptions, for a period of eighteen months from the date of the Confidentiality Agreement.

Representation on the Company s Board of Directors

The Merger Agreement provides that upon the Acceptance Time, and at all times thereafter, Parent will be entitled to designate a number of the Company s directors, rounded to the next whole number, equal to the percentage that the number of shares of Common Stock beneficially owned by Parent, Offeror or any of their affiliates, immediately following the Acceptance Time, bears to the total number of shares of Common Stock outstanding at the Acceptance Time. Under the terms of the Merger Agreement, the Company will take all actions reasonably necessary to effect the election of said directors to the Board. The Board, upon Parent s request following the Acceptance Time, and at all times thereafter, will cause the number of Parent s designees (rounded up to the next whole number) to constitute the same percentage as is on the Board of (i) each committee of the Board (other than the Special Committee of the Board), (ii) each board of directors (or similar body) of each subsidiary of the Company and (iii) each committee (or similar body) of each such board, in each case, to the extent permitted by applicable Law and the rules and regulations of the NASDAQ Global Stock Market (the Nasdaq). However, prior to the Merger Effective Time, the Board will include at least two of the Company s current directors (the Continuing Directors) (including at least two members of the Special Committee of the Board, as then constituted, for so long as such persons are willing and able to serve as members of the Special Committee of the Board). In addition, after Parent s designees are elected or appointed to the Board and until the Merger Effective Time, approval by a majority of the Continuing Directors will be required to (i) amend or terminate the Merger Agreement on behalf of the Company; (ii) amend the Company Charter or Company Bylaws (each as defined in the Merger Agreement); (iii) approve any extensions of time for the performance of any of the obligations or other acts of Parent or Offeror pursuant to the Merger Agreement; (iv) waive compliance with any covenant of Parent or Offeror or any condition to any obligation of the Company or any

waiver of any right of the Company under the Merger Agreement; (v) authorize any Adverse Recommendation Change (as defined in the Merger Agreement); and (vi) any other consent or action by the Company or the Board with respect to the Merger Agreement, the Offer or the Merger or any transaction contemplated thereby or in connection therewith.

The foregoing summary concerning representation on the Board does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, which has been filed as Exhibit (e)(1)(A) hereto, and the First Amendment, which has been filed as Exhibit (e)(1)(B) hereto, and which are incorporated herein by reference.

Item 4. ***The Solicitation or Recommendation***

(a) Recommendation

The Board recommends that you accept the Offer and tender your shares of Common Stock into the Offer. After careful consideration by the Board, including a thorough review of the Offer with its outside legal and financial advisors and the Company s senior management, and after receiving the unanimous recommendation of the Special Committee of the Board in favor of the transaction, at a meeting held on June 3, 2007, the Board, among other things, by the unanimous vote of all directors:

(i) authorized the execution, delivery and performance of the Merger Agreement and all of the transactions contemplated thereby, including the Offer and the Merger;

(ii) approved the Merger Agreement and the transactions contemplated thereby, including the Offer and the Merger, on the terms and subject to the conditions set forth therein, and in accordance with the DGCL;

(iii) determined that the Offer and the Merger, and the other transactions contemplated by the Merger Agreement, are advisable, fair to and in the best interests of the stockholders;

(iv) determined to recommend that the Company s stockholders accept the Offer, and tender their shares of Common Stock into the Offer; and

(v) determined to recommend, to the extent required, that the stockholders of the Company approve the Merger and adopt the Merger Agreement.

In particular, the Board believes that the Offer offers premium value to the Company s stockholders on the most accelerated timetable available, and is likely to be completed. A letter to the Company s stockholders communicating the Board s recommendation is filed herewith as Exhibit (a)(2)(A) and is incorporated herein by reference in its entirety.

The First Amendment was approved by the unanimous vote of the Board, after receiving the unanimous recommendation of the Special Committee, at a meeting held on June 15, 2007.

(b) Background and Reasons for the Recommendation

(a) Introduction: Industry Conditions

In the third quarter of 2006, the non-prime mortgage market in which the Company operates was characterized by increased competition for loans and customers which simultaneously lowered profit margins on loans and caused lenders to be more aggressive in making loans to relatively less qualified customers. By the end of 2006, the non-prime mortgage industry was clearly being negatively impacted. The sustained

pricing competition and higher risk portfolios of loans reduced the appetite for loans among whole loan buyers, who offered increasingly lower prices for loans, thereby shrinking profit margins for non-prime lenders. In addition, the higher levels of credit risk taken on by non-prime lenders resulted in higher rates of delinquency in the loans held for investment and in increasing frequency of early payment defaults and repurchase demands on loans that had been sold. These trends accelerated during the first quarter of 2007, and the industry experienced a period of turmoil which has continued into the second quarter 2007. As of mid-June 2007, more than 50 mortgage

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companies operating in the non-prime mortgage industry have failed and many others face serious operating and financial challenges. The most notable of these failures is New Century Mortgage Corporation (New Century), one of the largest non-prime originators in recent years, which announced in early April 2007 that it would file for bankruptcy protection.

It now appears that an underlying reason for the deterioration of industry conditions was the relatively poor performance of loans originated in 2006 in comparison to loans originated in 2004 and 2005. While real estate markets were booming during 2004 and 2005, and some areas experienced significant home price appreciation, many originators extended credit and underwriting standards to meet market demands. When home price appreciation leveled off, or in some areas declined, many of the loans originated in 2006 did not perform up to expectations. This decline in performance led to increases in the cost of securitizing non-prime loans as the rating agencies which rate non-prime securitizations increased loss coverage levels, requiring higher credit support for non-prime securitizations.

During the first four months of 2007, a number of significant industry events occurred, including the following:

New Century announced that it would restate results for the nine months ended September 30, 2006 to account for losses on defaulted loans that it was obligated to repurchase (February 7th);

HSBC Holdings PLC, one of the world s largest banks and non-prime lenders, announced an increase in its bad debt charge for 2006, which it attributed to problems in its U.S. non-prime mortgage lending division (February 8th);

Credit-Based Asset Servicing and Securitization LLC (C-BASS) and Fieldstone Investment Corporation (Fieldstone) announced that they had entered into a definitive merger agreement under which C-BASS would acquire all of Fieldstone s outstanding common stock (February 16th);

ACC Capital Holdings, the parent company of Ameriquest Mortgage Company and Argent Mortgage Company, two large non-prime mortgage originators, announced that it had secured additional capital from Citi s Markets and Banking Division and its majority shareholder, and that Citi had agreed to become the company s primary warehouse lender and had acquired an option to buy the company s wholesale mortgage business (February 28th);

Fremont General Corp. (Fremont), another significant non-prime mortgage originator, announced that it would exit its non-prime real estate lending operations and that it was in discussions with various parties regarding the sale of this business (March 2nd);

The New York Stock Exchange suspended trading of New Century s common stock based on uncertainties concerning its liquidity position (March 12th);

Fieldstone announced that it had amended its previously announced merger agreement with C-BASS to reduce the price of Fieldstone s common stock to $4.00 per share (March 16th);

People s Choice Home Loan, Inc., another significant non-prime mortgage originator, filed for bankruptcy protection (March 20th);

Fremont sold approximately $4.0 billion of non-prime residential real estate loans and entered into exclusive negotiations with the same institution to sell most of its residential real estate business (March 21st);

New Century filed for bankruptcy protection (April 2nd);

NovaStar Financial, another significant non-prime mortgage originator, initiated a formal process to explore strategic alternatives and received $100 million in financing (April 11th); and

H&R Block Inc. announced the sale of Option One Mortgage Corp. (Option One), another large non-prime mortgage originator, to an affiliate of Cerberus Capital Management with a transaction value equal to Option One s tangible net assets as of the date of closing less $300 million (April 20th).

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The combination of these events with the continued heavy repurchase demands from whole loan purchasers experienced during this period created a cycle beginning with a significant increase in the amount of distressed loans for sale in the market. This increase in loan supply reduced whole loan prices, providing a basis for warehouse line providers to mark down the collateral value of loans held in inventory and, as a result, to place margin calls on non-prime lenders. These increased margin calls resulted in more distressed sales which, in turn, put further downward pressure on whole loan sale prices, regenerating the cycle with escalating negative results.

(b) Background of the Transaction

On February 14, 2007, the Company announced its 2006 earnings. The Company reported that its loan reserve balances at December 31, 2006 had been increased substantially over the level of reserves at September 30, 2006, reflecting increasing delinquency trends and repurchase activity, and noted the challenging conditions in the marketplace. During the earnings call that same day, the Company also reported that it had notified its credit providers of losses incurred in the fourth quarter of 2006 and the potential for losses in the first quarter of 2007, and that it had obtained waivers of defaults that would have otherwise occurred under certain covenants in its credit facilities. In addition, the Company indicated that it had moved aggressively to address the current market conditions, including tightening underwriting guidelines and disciplines, increasing reserves, and taking steps to bolster liquidity.

On March 1st, the Company filed a Form 12b-25 with the SEC stating that it would not be able to timely file its Annual Report on Form 10-K for the year ended December 31, 2006 (the 2006 Form 10-K). Pursuant to the Form 12b-25, the deadline for the 2006 Form 10-K was extended until March 16, 2007. During the first two weeks of March, the Company s warehouse lenders aggressively marked down collateral and the Company experienced additional margin calls. These margin calls placed a severe strain on the Company s liquidity and caused the Company to conduct an in-depth review of its market position and strategies for dealing with the negative conditions in the market. In connection with this review, members of the Company s senior management met in early March with representatives of two investment banking firms, Bear, Stearns & Co. Inc. (Bear Stearns) and Friedman, Billings, Ramsey & Co., Inc. (FBR), to discuss the ability of the Company to obtain an immediate infusion of capital.

On March 11th, at a special meeting, the Board reviewed and discussed with management the Company s situation, including increased margin calls and the resulting pressure on the Company s liquidity. The Board also noted that the closing price of the Common Stock on the Nasdaq on the preceding business day (Friday, March 9), was $15.78 per share.

The discussion then turned to a possible financing transaction. Management reported that, based on its discussions with Bear Stearns and FBR, it was highly unlikely that any investor would provide debt financing to the Company without an equity incentive, such as warrants to purchase shares of Common Stock, and that an equity capital raise in an amount sufficient to meet the Company s immediate needs would have to be at a level and at a price which would be substantially dilutive to existing stockholders.

An extensive discussion of the available options for the Company followed, including discussion of a possible private placement of equity or debt securities and a possible sale of the Company. Management reported on the potential counterparties with which discussions were being pursued, including Farallon Capital Management, L.L.C. (Farallon). The Board also discussed the possibility that, if the Company were unable to complete a capital raising transaction and conditions in the marketplace continued to deteriorate, with further erosion in the Company s liquidity, a bankruptcy filing might be necessary.

A representative of Dewey Ballantine LLP, legal counsel to the Company (Dewey Ballantine), then advised the directors of their legal duties generally and in connection with pursuing a potential private placement of equity which would be dilutive to existing stockholders or a potential sale of the Company in particular. This advice included discussion of the legal duties of the Board toward stockholders and potentially creditors to the extent the Company were to approach insolvency.

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The Board then resumed a general discussion of all options available to the Company, including the possibility of a bankruptcy filing, and determined that the audit committee of the Board (the Audit Committee, as a subset of the directors comprised solely of non-employee directors) should contact Houlihan Lokey Howard & Zukin Capital, Inc. (HLHZ) concerning the possible engagement of HLHZ to advise the Audit Committee on alternatives available to the Company, especially regarding bankruptcy. In addition, the Board approved the engagement letter of FBR, dated March 9th, for advice relating to a possible transaction involving a private placement of equity. The Board also discussed a proposed engagement letter for Bear Stearns, parallel to the FBR engagement, which would be limited to exploration of such a private placement with a specified list of possible investors. Management reported that Bear Stearns had suggested that its engagement letter should also cover the possibility of a strategic transaction with any of such designated investors.

The Board next met on March 12th, and approved the engagement letter of Bear Stearns on the terms which had been discussed at the previous day s Board meeting. Also at that meeting, at the request of the directors, a representative of Dewey Ballantine provided an overview of the bankruptcy process. Dewey Ballantine then reviewed with the Board its fiduciary duties and answered questions from directors.

Between March 12th and March 16th FBR and management of the Company contacted and met with numerous institutional investors, under confidentiality agreements, regarding a potential private placement of equity or equity-linked securities of the Company.

On March 13th, the Company publicly announced that it was exploring various strategic options, including raising additional capital to increase liquidity. The Company further reported the severity of the margin calls on its credit facilities since January 1st (the majority of which had been received by the Company during the preceding four weeks) and that it was seeking further waivers and extensions of waivers of certain financial and operating covenants under its credit facilities, including waivers related to required levels of net income. The Company repeated its statement from its February 14th earnings call that it had been operating under various waivers under these facilities since December 31st.

The Board met on March 13th, and was presented with a report by management as to the day s events, including reaction to the Company s press release and discussions with lenders, and the fact that the closing price of the Common Stock on the Nasdaq had been $3.97, a decline of $7.43 from the prior day s closing price of $11.40. Management also provided an update as to the Company s liquidity position, additional margin calls received, and the status of Bear Stearns and FBR s efforts with regard to a private placement of equity or other capital raising transaction.

The Board met twice on March 14th. At its initial meeting, management provided an update as to liquidity and margin calls. At the second meeting, the discussion focused on a possible sale of the Company s loan portfolio to one of several parties that might be interested. Although the sale would be at a substantial discount, it would improve the Company s liquidity and reduce its exposure to margin calls.

At a meeting held on March 15th, the Board authorized the sale of substantially all of the Company s loan portfolio to Citigroup Global Markets Realty Corp. (Citigroup). Also at that meeting, the Board was informed by management that Farallon was interested in making a proposal to the Company to provide a loan, in connection with which they would receive warrants to purchase shares of Common Stock, and possibly also to acquire the Company. At a second meeting that same day, management reported on its progress in implementing the sale of the loan portfolio to Citigroup, scheduled to be completed the following day, and on the potential proposal from Farallon. Management also discussed the anticipated timing of receipt of the auditors opinion on the Company s 2006 financial statements and the fact that, since the audit had not yet been completed, the Company would be unable to file the 2006 Form 10-K on its extended due date of March 16th.

On March 16th, the Company announced the sale of the loan portfolio and also that it would not be able to file the 2006 Form 10-K by the extended deadline for filing. The Company further reported that it continued to seek waivers and extensions of waivers under its credit facilities. In addition, the Company stated that the entire

amount of goodwill established as a result of the acquisition of Aames Investment Corporation had been impaired and would be charged-off in the quarter ended December 31, 2006.

Later that same day, the Board met for a second time. At that meeting, management presented a report on the state of the business and the continuing challenges faced by the Company, notwithstanding the liquidity provided by the completion of the sale of the loan portfolio to Citigroup. These challenges included actual and potential management resignations, decreased availability of warehouse financing, the status of the audit of the Company s 2006 financial statements, the Company s cash forecast and its need for additional liquidity, and the unfavorable conditions in the secondary market with regard to securitization opportunities. Following this presentation, the Board discussed the terms of a proposal received from Farallon as set forth in a term sheet received and distributed to directors prior to the meeting. The proposal included a term loan in the amount of $200 million bearing interest at 14.00% per annum and maturing in five years, in connection with which Farallon would receive warrants to purchase approximately 3.23 million shares of Common Stock at an exercise price of $9.43 per share (which warrant shares, when taken together with Farallon s prior ownership of shares of Common Stock representing about 6.9% of the Company s outstanding shares, would cause Farallon s total ownership to increase to about 19.9% of the outstanding shares). The term loan proposal was coupled with a proposal to acquire the Company, which contemplated a 25-day go-shop period and included a requirement that management roll over all of its existing equity ownership in the Company into the newly merged company.

At the request of the Board, a representative of Dewey Ballantine then reviewed the legal duties of the Board in connection with its consideration of the Farallon proposal. After extensive discussion of the Farallon proposal in the context of the Company s immediate need for additional cash and the potential availability to the Company of opportunities for alternative transactions, the Board determined to expand the engagement of Bear Stearns to include exploration of all strategic alternatives available to the Company. The Board then instructed Bear Stearns and Dewey Ballantine to engage in discussions of the possible transaction with Farallon and its advisors and to report back to the Board at a meeting scheduled for the following day.

At its meeting on March 17th, the Board was advised that discussions with Farallon and its legal counsel had resulted in a mutual determination to proceed with negotiation of the loan transaction and to defer the proposal to acquire the Company. The Board then discussed the opportunity presented by the deferral of the acquisition proposal to undertake a thorough and comprehensive strategic review process, including a consideration of the potential sale of the Company, and instructed Bear Stearns to begin working with management to gather and assemble information and diligence materials regarding the Company that would be required in order to commence a strategic review process. The Board directed management and the Company s legal and financial advisors to continue to negotiate the loan transaction with Farallon, and emphasized that the terms of the loan should not impede a strategic transaction with a party other than Farallon.

At the first of two Board meetings held on March 18th, the Board received a report on the status of the negotiation of the loan transaction with Farallon. At the second Board meeting held later that day, the Board reviewed and discussed a revised term sheet for the loan and authorized management to proceed to negotiate and deliver loan transaction documents on the terms set forth in the revised term sheet.

On March 19th, the Company announced that it had received a notice that the Company s stock was subject to delisting from the Nasdaq as a result of not having filed the 2006 Form 10-K prior to expiration of the extended filing deadline and that the Company would appeal the delisting. The Company further reported that a class action lawsuit had been filed against the Company and certain of its officers and directors asserting various securities law claims based upon certain disclosures made by the Company during the period from November 1, 2005 to March 12, 2007, and that the Company assessed the lawsuit to be without merit and would defend it vigorously.

At a Board meeting held on March 20th, management reported that the Farallon term loan commitment letter had been signed, and that a press release announcing the commitment letter had been issued that morning prior to the opening of the securities markets. The commitment letter provided for a $200 million loan at an

interest rate of 13% per year with a five-year term, and for the issuance to Farallon at the closing of the loan transaction of warrants to purchase about 3.23 million shares of Common Stock at an exercise price of $10.00 per share. Management also reported on its efforts to obtain or maintain certain levels of warehouse financing, which was a condition to the funding of the Farallon loan, and on the Nasdaq delisting notice and appeal process.

Bear Stearns then reported to the Board on the steps it would take in connection with commencement of a process to explore strategic alternatives available to the Company, including the sale of the Company or an alternative transaction such as a large equity financing. The Board then considered the desirability of forming a special committee of the Board (the Special Committee) to oversee the strategic review process and to negotiate the terms of any potential transaction. In this regard, the Board noted that the acquisition proposal which had been received from Farallon contemplated equity participation by management, and further noted the filing by Farallon with the SEC earlier that day of a Schedule 13D disclosing that Farallon had had discussions with the Company, its officers, members of the Board and other persons regarding the possible acquisition of the Company, that Farallon intended to continue to have such discussions from time to time, and that Farallon might approach one or more senior executive officers of the Company or the Company with respect to such officers or the Company s participation in any such possible transaction. After discussion, the Board determined that it would be advisable to form a Special Committee comprised solely of non-employee directors. The non-management directors undertook to determine among themselves who would serve on the Special Committee and to report back to the full Board at its next meeting, scheduled for the following day. The Board then instructed management that all contacts in respect of strategic transactions were to be handled by Bear Stearns under the supervision of the Special Committee.

At the Board meeting held on March 21st, Bowers W. Espy, Jody A. Gunderson and Richard T. Pratt were formally appointed as members of the Special Committee, with Mr. Espy as chair. The Special Committee reported to the Board that it had determined to engage Morris Nichols Arsht & Tunnell LLP (MNAT) as its counsel, and representatives of MNAT then joined the Board meeting. There followed a presentation by Bear Stearns on strategic alternatives and a report by management regarding its ongoing efforts to obtain or maintain certain levels of warehouse financing in order to satisfy the condition to the funding of the Farallon loan. The first meeting of the Special Committee commenced immediately following the full Board meeting, and included a discussion of the Committee members fiduciary duties, the structure of the strategic process, changing the engagement of Bear Stearns from an engagement with the Company to an engagement with the Special Committee, and possible effects on the strategic review process of the warrants to be issued to Farallon in connection with the Farallon loan. At this meeting, the Special Committee also resolved to engage HLHZ as a financial advisor to the Special Committee (since HLHZ s initial engagement by the Audit Committee was only for the March 2007 calendar month).

On March 22nd, the Company held a Board meeting at which, upon the request of the Special Committee, it authorized the amendment and restatement of the engagement letter with Bear Stearns to provide that Bear Stearns would be a financial advisor to the Special Committee concerning potential strategic alternatives. Also at that meeting, management reported that a discussion with the audit partner at Grant Thornton LLP, the Company s independent certified public accountants (Grant Thornton), suggested there was some possibility that Grant Thornton would not complete the pending audit of the Company s 2006 financial statements, and that management would endeavor to persuade Grant Thornton to complete the audit on a timely basis. The Special Committee met immediately following the March 22 Board meeting and resolved to retain FBR as an additional financial advisor to the Special Committee, and directed FBR to advise the Special Committee concerning the possibility of an equity-linked security private placement.

On March 23rd, the Special Committee met and considered the possibility that Grant Thornton would resign without completing its audit of the Company s 2006 financial statements and the potential impact such a resignation might have on any potential transaction. Representatives of Bear Stearns discussed a list of potential strategic and financial transaction partners who could be contacted to solicit their interest in a transaction with the Company. After consulting with Bear Stearns and HLHZ, the Special Committee determined that interest

should be solicited from a broad range of both strategic buyers and financial investors. Representatives of Bear Stearns discussed with the Special Committee the possible process and timing of a possible strategic transaction, including a sale of the Company. The Special Committee decided that potential transaction partners should be contacted as soon as possible to determine their interest in a possible transaction with the Company. Bear Stearns described the launch of the solicitation process, including distribution of a brief summary of information regarding the Company, a process letter and a draft confidentiality agreement to potential transaction partners. The Special Committee requested that MNAT and HLHZ provide comments on the materials to be distributed by Bear Stearns and requested that HLHZ provide comments and/or additions to the list of entities Bear Stearns had proposed to contact. Subject to comments received from MNAT and HLHZ, the Special Committee authorized Bear Stearns to launch the solicitation process.

On March 23rd, Bear Stearns began to contact parties who might be interested in entering into a transaction with the Company. Bear Stearns contacted 63 potentially interested parties (including 22 potential strategic buyers) as part of the first round of the process. Between March 24th and April 9th, 20 potentially interested transaction partners (including six potential strategic buyers) entered into confidentiality agreements with the Company and were given access to the virtual data room that had been set up by the Company and Bear Stearns. One of these parties was Lone Star, which executed a confidentiality agreement dated as of March 24th.

On March 23rd, the full Board met. Management and Ms. Gunderson, the chair of the Audit Committee, reported on recent discussions with Grant Thornton and on the Company s efforts to set up a meeting with Grant Thornton. Management reported that Farallon had been told about the possible resignation of Grant Thornton and was still willing to proceed with the loan transaction. There followed a discussion of the potential impacts of a resignation by Grant Thornton on the Company s licenses and on the pending appeal of the Nasdaq delisting. At the direction of the Special Committee, Bear Stearns then reported to the full Board on the commencement of the solicitation process and the distribution of materials to potentially interested parties.

On March 26th, the Company held a Board meeting at which management presented an update as to its efforts to obtain or maintain certain levels of warehouse financing, the status of the Farallon loan and related documentation, and its continued efforts to set up a meeting with Grant Thornton. At the direction of the Special Committee, Bear Stearns then provided an update to the full Board as to the solicitation of indications of interest in a transaction with the Company.

The Special Committee held two meetings on March 26th, in order to consider the possibility of the resignation of Grant Thornton and how that potential resignation, as well as the closing of the term loan from Farallon, could impact the process of pursuing strategic alternatives.

On March 27th, the Company held a Board meeting, at which it was reported that Grant Thornton had orally communicated its resignation as the Company s independent certified public accountants and that, in connection with its resignation, Grant Thornton had advised that it believed it would have had to significantly expand the scope of its audit of the Company s financial statements for the year ended December 31, 2006 in order to be able to complete the audit. There followed a discussion of the potential effects of such resignation on the Company, including the further delay of the filing of the 2006 Form 10-K, and on what steps could be taken to persuade Grant Thornton not to resign and, if such efforts were not successful, to engage a new firm of independent certified public accountants as promptly as practicable. Management also provided an update as to the status of the Farallon loan and related documentation. The Special Committee convened a meeting immediately following the Board meeting to discuss further the impact of the Grant Thornton resignation on the strategic review process.

Also on March 27th, Lone Star engaged in initial discussions with Bear Stearns regarding potential opportunities for a transaction between Lone Star and the Company. On that day, Lone Star received access to a virtual data room established by the Company for the purpose of making available to potential bidders or strategic partners certain confidential documents relating to the Company.

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On March 28th, the Company held a Board meeting, at which management reported that Farallon had agreed to increase the amount of the loan from $200 million to $230 million. The Special Committee convened after the full Board meeting and discussed next steps with regard to the solicitation process and with respect to the Company s efforts to complete the audit of the 2006 financial statements.

The Special Committee held two meetings on March 29th, to review the solicitation process to date and to discuss the going-forward process. At these meetings, the Special Committee was informed that a potential transaction partner that had sought to meet with management of the Company on an accelerated timeline had dropped out of the process.

On March 30th, the Company held a Board meeting at which management reported that the Farallon loan had been funded in the amount of $230 million. It was also reported at that meeting that the Audit Committee had received, earlier that day, a letter from Grant Thornton, dated March 27, 2007, regarding its resignation as the Company s independent auditors. The Special Committee convened a meeting immediately thereafter to discuss these developments and the general status of the strategic review process.

On April 2nd, the Company announced the closing of the term loan with Farallon. The Company also reported on other events, including a new warehouse facility in the amount of $500 million and the renewal of an existing facility in the amount of $600 million, the resignation of Grant Thornton, and that the Company continued to work with its financial and legal advisors to explore various strategic options, including, without limitation, raising additional capital, a merger or another strategic transaction.

On April 9th, the Special Committee held a meeting at which Bear Stearns updated it on the status of the first round of the strategic review process.

Between April 9th and April 17th, Bear Stearns received initial indications of interest from seven parties, two of which sent in revised first round bids between April 13th and April 17th. Of the seven proposals received in this first round, two were from strategic buyers and five were from financial investors, with the amounts of the proposed transactions ranging from $9.00 to $17.00 per share of Common Stock (based on purchase price for an outright acquisition and conversion price for a contemplated equity investment). Lone Star s proposed transaction indicated a valuation of $17.00 per share of Common Stock.

On April 10th, the Company announced that it had retained Squar, Milner, Peterson, Miranda & Williamson, LLP (Squar Milner) as its new firm of independent public accountants.

On April 11th, the Special Committee held a meeting at which Bear Stearns discussed the first round bids. The Special Committee agreed to allow four of the participants to proceed to the second round and deferred making a decision as to the other three participants. One of the four participants that the Special Committee invited into the second round was Lone Star. Also at that meeting, the Special Committee instructed MNAT to work with Dewey Ballantine to begin drafting a merger agreement to be distributed to potential acquirors.

On April 16th, the Special Committee held a meeting at which FBR made a presentation on a private placement of equity as a potential transactional approach.

On April 17th, the Special Committee held a meeting and discussed the FBR presentation. There was a preliminary decision made not to proceed with solicitations of interest for a private placement of equity, but to instruct FBR to be prepared in the event the Special Committee determined to proceed with that option. Also at this meeting, the Special Committee decided to allow into the second round two of the three bidders it had deferred making a decision on at the April 11th meeting, which brought the total number of bidders allowed into the second round to six. One party was excluded from this process because the Special Committee concluded, after consulting with Bear Stearns and HLHZ, that its bid was similar in structure but substantially inferior to a proposal received from another one of the parties.

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Through the remainder of April and into early May, the six remaining parties continued their due diligence investigations of the Company. During this period, the Company provided additional documents and information in response to requests from the remaining participants.

On April 23rd, the Special Committee held a meeting at which Bear Stearns provided an update on the remaining participants due diligence process and on the management presentations. Also at that meeting, the Special Committee discussed the extent to which the unavailability of the Company s 2006 audited financial statements might impede or delay the Company s ability to complete a transaction as well as issues generally regarding management retention.

The Special Committee met several times over the course of the next three weeks in order to receive updates on the status of the remaining participants due diligence process and on the management presentations, as well as to discuss potential valuation models for the hybrid investment proposals certain of the potential transaction partners had submitted, (proposals for transaction involving both the purchase of convertible securities of the Company and the formation of a joint venture or other type of partnership which would invest in certain of the Company s mortgage products, including whole loans, tranches of future securitizations and residual assets), the extent to which the unavailability of the Company s 2006 audited financial statements might impede or delay the Company s ability to complete a transaction, and issues generally regarding management retention. At a meeting held on April 26th, at the request of the Special Committee, Bear Stearns provided an overview of the status of the strategic process and of the expected timing of solicitation and receipt of second round bids. Bear Stearns also noted that, since the commencement of the strategic review process, the book value of the Company s common equity had declined.

The Special Committee decided on May 4th as the deadline for the submission of second round proposals. On April 30th, at the instruction of the Special Committee, Bear Stearns distributed the second round bid materials, including a bid procedures letter and a draft merger agreement (the Draft Agreement) to four participants, one of which was Lone Star, and Bear Stearns distributed to one additional participant, because its interest was solely in a hybrid investment and not in an acquisition of the Company, a set of the bid materials excluding the Draft Agreement. Bear Stearns distributed the second round bid package, including the Draft Agreement, to one additional bidder on May 2nd.

On April 30th, in connection with its receipt of the second round bid materials, Lone Star s legal counsel, Sullivan & Cromwell LLP (S&C), had discussions with Dewey Ballantine regarding the proposed structuring of an acquisition transaction and certain federal securities law and other issues affecting the nature and timing of a potential acquisition transaction. In the following week, Lone Star and its financial and legal advisors continued to conduct its due diligence investigation, including several discussions with Company management and its legal counsel of outstanding litigation matters to which the Company and its directors were parties.

During the period from May 4th to May 9th, Bear Stearns received second round bids from five of the remaining six participants scheduled to respond by the initial deadline set by the Special Committee. Bear Stearns compared each of the bids received and discussed them with the Special Committee. Two of the bids proposed an acquisition of the Company, two of the bids proposed a hybrid investment, and one bid included proposals for both an acquisition and a hybrid investment. The amounts of the proposed bids ranged from $8.00 to $13.00 per share of Common Stock (based on purchase price for an outright acquisition and conversion price for a contemplated equity investment). Among these bids was a second round bid letter submitted by Lone Star indicating that Lone Star on May 7th then was prepared to make an offer for the acquisition of control of the Company involving a valuation range of $11.00-$13.00 per share and certain other terms and conditions with respect to such a transaction.

On May 10th, Bear Stearns discussed the second round bids with the Special Committee. The Special Committee discussed issues concerning other possible scenarios including maintaining the status quo, a stand-alone issuance of convertible securities, and a hybrid investment. When asked for their recommendations, both Bear Stearns and HLHZ advised that the pursuit of a sale transaction would likely be the best option to maximize