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SILVERADO FINANCIAL INC  
Form 10QSB  
December 23, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

Commission File Number 000-29049

SILVERADO FINANCIAL, INC.

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(Exact name of small business issuer as specified in its charter)

Nevada

86-0824125

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(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification Number)

5976 W. Las Positas, Suite 218, Pleasanton, CA 94588

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(Address of principal executive offices) (Zip Code)

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Telephone Number: (925) 227-1500

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
Yes [X] No [ ]

As of September 30, 2005, 20,164,062 of the registrant's common stock, \$0.01 par value per share, were issued and outstanding and 100,000 shares of the registrants preferred were issued and outstanding.

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For the Nine Months Ended September 30, 2005 and 2004

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#### PART I -- FINANCIAL INFORMATION

##### ITEM 1. FINANCIAL STATEMENTS

###### Report of Independent Accountants

To the Board of Directors and Stockholders Silverado Financial, Inc.  
Pleasanton, California

We have reviewed the accompanying consolidated balance sheets of Silverado Financial, Inc. (a Nevada corporation), as of June 30, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and cash flows

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for the three and six months then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Silverado Financial, Inc.

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note One to the financial statements, the Company's significant operating losses raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

SALLMANN, YANG & ALAMEDA  
An Accountancy Corporation  
Pleasanton, California

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Silverado Financial, Inc.

Consolidated Balance Sheets

	September 30, 2005	September 30, 2004
	-----	-----
Assets		
Current assets		
Cash	\$ 43,792	\$ 63,927
Accounts receivable	87,010	3,324
Mortgage receivable	524,300	--
Investment receivable	22,510	--
Prepaid expenses	22,668	--
	-----	-----
Total current assets	700,280	67,251
Property and equipment		
Furniture and equipment	406,543	146,271
Intellectual property	699,010	--
Accumulated depreciation and amortization	(438,778)	(38,843)
	-----	-----
Total property and equipment	666,775	107,428
Other assets		
Deposits	58,571	11,547
Other intangibles	--	699,010
Goodwill	2,985,471	--
	-----	-----
Total other assets	3,044,042	710,557
	-----	-----
Total assets	\$ 4,411,097	\$ 885,236

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See accountants' report and accompanying notes

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Silverado Financial, Inc.

Consolidated Balance Sheets

	September 30,	
	2005	2004
	-----	-----
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 289,190	\$ 293,204
Warehouse facility payable	524,300	--
Notes payable current portion	531,114	--
Notes payable - stockholders	66,384	--
Due to affiliates	--	939
Equity advances	165,500	--
Convertible notes	--	36,000
Accrued liabilities	5,482	185,766
Accrued wages	529,514	--
Payroll taxes payable	287,601	--
Income taxes payable	2,400	--
	-----	-----
Total current liabilities	2,401,485	515,909
Long term debt		
Notes payable - long term portion	1,297,000	275,000
	-----	-----
Total long term debt	1,297,000	275,000
	-----	-----
Total liabilities	3,698,485	790,909
Stockholders' equity		
Preferred stock, \$.001 par value, 1,000,000 shares authorized, 100,000 and 0 shares issued and outstanding, respectively	1,000,000	--
Common stock, \$.001 par value, 20,000,000 shares authorized, 19,635,524 and 20,164,062 shares issued and outstanding, respectively	19,635	18,077
Additional paid in capital	11,050,161	10,879,985
Deferred compensation	--	(7,030)
Accumulated deficit	(11,357,184)	(10,796,705)
	-----	-----
Total stockholders' equity	712,612	94,327
	-----	-----
Total liabilities and stockholders' equity	\$ 4,411,097	\$ 885,236
	=====	=====

See accountants' report and accompanying notes

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Silverado Financial, Inc.

Consolidated Statements of Income

	For the Three Months Ended September 30,		For the Nine Months Ended September	
	2005	2004	2005	2004
Income				
Net sales	\$ 1,026,469	\$ 223,908	\$ 2,434,091	\$ 1,026,469
Cost of sales	136,376	--	437,959	136,376
Gross profit	890,093	223,908	1,996,132	890,093
Operating expenses				
Selling, general and administrative expenses	1,134,921	350,273	2,550,529	1,134,921
Depreciation and amortization	92,511	7,114	231,841	92,511
Total operating expenses	1,227,432	357,387	2,782,370	1,227,432
Operating loss	(337,339)	(133,479)	(786,238)	(337,339)
Other income (expense)				
Interest income	2,667	--	10,481	2,667
Gain on sale of investments	--	--	--	--
Investment income	24,307	--	51,297	24,307
Interest expense	(52,989)	(6,454)	(76,010)	(52,989)
Impairment	--	(699,010)	--	--
Total other income (expense)	(26,015)	(705,464)	(14,232)	(26,015)
Loss before income taxes	(363,354)	(838,943)	(800,470)	(363,354)
Provision for income taxes	--	--	3,200	--
Net loss	\$ (363,354)	\$ (838,943)	\$ (803,670)	\$ (363,354)
Loss per share (basic)	\$ (0.02)	\$ (0.05)	\$ (0.04)	\$ (0.02)
Loss per share (dilutive)	\$ (0.02)	\$ (0.05)	\$ (0.04)	\$ (0.02)

See accountants' report and accompanying notes

Silverado Financial, Inc.

Consolidated Statements of Stockholders' Equity  
For the Nine Months Ended September 30, 2005 and 2004

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	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deferred Compensation	Accumulated Deficit
Balance, December 31, 2003	14,839,492	\$ 14,839	\$ 10,455,513	\$ (16,000)	\$ (9,560,541)
Shares issued for payables	2,062,975	1,154	153,051	--	--
Shares issued for services	2,115,325	1,183	154,921	8,970	--
Shares issued for cash	1,146,270	901	116,500	--	--
Net loss	--	--	--	--	(1,236,164)
Balance, September 30, 2004	20,164,062	\$ 18,077	\$ 10,879,985	\$ (7,030)	\$ (10,796,705)

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital
Balance, December 31, 2004	--	\$ --	18,216,697	\$ 18,217	\$ 10,889,713
Shares issued for payables	100,000	1,000,000	984,691	984	81,722
Shares issued for services	--	--	634,136	634	86,383
Shares returned for services	--	--	(200,000)	(200)	(7,657)
Net loss	--	--	--	--	--
Balance, September 30, 2005	100,000	\$ 1,000,000	19,635,524	\$ 19,635	\$ 11,050,161

See accountants' report and accompanying notes

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Silverado Financial, Inc.

Consolidated Statements of Cash Flows

	For the Three Months Ended September 30,		For the
	2005	2004	Ended S 2005
Operating activities			
Net loss	\$ (363,354)	\$ (838,941)	\$ (803,670)
Adjustments to reconcile net loss to cash flows from operating activities:			
Depreciation and amortization	92,511	18,214	231,841
Loss on sale of marketable securities	--	--	--
Stock for services and payables	(59,465)	45,936	110,188
Impairment	--	699,010	--
(Increase) decrease in:			
Accounts receivable	(55,682)	(321)	(70,124)

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Mortgage receivable	(279,300)	--	(524,300)
Investment receivable	4,480	--	(22,510)
Prepaid expenses	5,018	--	(11,744)
Deposits	(13,893)	--	(36,673)
Increase (decrease) in:			
Accounts payable	71,653	19,630	233,320
Warehouse facility payable	279,300	--	524,300
Due to affiliates	--	53,500	--
Equity advances	95,000	--	165,500
Payroll taxes payable	40,527	--	201,304
Income taxes payable	1,600	--	2,400
Accrued wages	135,359	--	323,082
Accrued liabilities	(102,198)	5,458	(5,823)
	-----	-----	-----
Net cash provided by (used in) operating activities	(148,444)	2,486	317,091
Investing activities			
Proceeds from the sale of investments	--	--	--
Purchases of property and equipment	(12,479)	--	(158,167)
Purchase of goodwill	--	--	(2,985,471)
	-----	-----	-----
Net cash provided by (used in) investing activities	(12,479)	--	(3,143,638)

See accountants' report and accompanying notes

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Silverado Financial, Inc.

Consolidated Statements of Cash Flows (continued)

	For the Three Months Ended September 30,		For the Ended S
	2005	2004	2005
	-----	-----	-----
Financing activities			
Proceeds from private placements of stock	\$ --	\$ 62,762	\$ --
Proceeds from issuance of preferred stock	--	--	1,000,000
Proceeds from issuance of notes payable	--	--	2,000,000
Proceeds from issuance of shareholder loan	22,617	--	22,617
Repurchase of shareholder stock	--	(43,767)	--
Payment on notes payable	(43,964)	--	(171,886)
	-----	-----	-----
Net cash provided by (used in) financing activities	(21,347)	18,995	2,850,731
Net increase (decrease) in cash	(182,270)	21,481	24,184
Cash at beginning of period	226,062	42,446	19,608
	-----	-----	-----
Cash at end of period	\$ 43,792	\$ 63,927	\$ 43,792
	=====	=====	=====
Supplemental disclosure of cash flow information:			
Interest expense	\$ 52,989	\$ --	\$ 76,010

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Income tax expense	\$	--	\$	--	\$	1,600
Supplemental disclosure of non-cash investing and financing activities:						
Receipt of 461,822 common shares for decrease in valuation of software purchased with Financial Software, Inc.	\$	--	\$	(23,091)	\$	--
Relinquishment of notes payable for decrease in valuation of software purchased with Financial Software, Inc.	\$	--	\$	(275,000)	\$	--
Adjustment of Goodwill for vehicle not purchased in acquisition of Core One Mortgage	\$	3,945	\$	--	\$	3,945

See accountants' report and accompanying notes

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Silverado Financial, Inc.  
Notes to Consolidated Financial Statements  
September 30, 2005 and 2004

### 1. Organization and Basis of Presentation

#### Nature of Operations

Silverado Financial, Inc. (the Company) is incorporated under the laws of the State of Nevada and based in Pleasanton, California in the San Francisco Bay Area. This Company provides first and second mortgage products to borrowers in California through its subsidiary Silverado Mortgage, Corporation.

The corporation was initially formed on February 26, 1987 as Toledo Medical Corporation. The name was changed to Almaz Space Corporation on February 9, 1991 and to Ready When You Are Funwear, Inc. on April 14, 1992. On February 17, 1995 the name was changed to Rhombic Corporation. On March 19, 2003 the company changed its name to Silverado Financial, Inc.

The Company's efforts, since inception, until October 2002, had been primarily focused on the acquisition of the rights to intellectual property that could lead to the development of innovative scientific technologies. During the years 1999 and 2000 it began to focus on the research and development of its portfolio of acquired intellectual property. During 2001, the main objective was to identify and develop specific applications from the intellectual property in order to make them commercially marketable. In November 2002, the Company acquired Financial Software, Inc. as the first part of its strategy to enter the financial services sector.

As of September 30, 2005, the Company had three wholly owned subsidiaries as follows:

- o Financial Software, Inc. (FSI)
- o Silverado Mortgage Corporation (SMC)
- o Core One Mortgage, Inc. (Core One)

On November 19, 2002, the Company acquired all of the issued and outstanding shares of Financial Software, Inc. (FSI) a New Jersey corporation engaged in the development of Internet and Intranet financial software in addition to operating several financial industry publishing websites. This acquisition was completed on a share for share exchange basis for 4,400,000 shares of the Company's common stock. FSI was acquired in order to gain access to certain proprietary software



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products owned by FSI, which the Company intends to further develop and extend into comprehensive mortgage platforms called MortgageCenter and FinanCenter. FSI transferred its state of incorporation to California in February 2003.

On May 9, 2003, in a non-arms length transaction with John E. Hartman, the Company's President, the Company issued 729,452 shares of restricted common stock at a purchase price of \$0.175 per share, which was based on the prior five days average trading price, in exchange for all of the outstanding shares of Silverado Mortgage Corporation (SMC). The purchase price of SMC was \$127,654 and was the net asset value of SMC, as determined by an independent, third party valuation. The shares were issued under Section 4(2) of the 1933 Securities Act.

On May 5, 2005 the Company acquired all of the issued and outstanding shares of Core One Mortgage, Inc., a Chicago based sub-prime mortgage broker ("Core One") along with entitlement to fifty percent of the future net income of Liberty Settlement Services (a Pennsylvania based title company), for \$3,000,000 in a combination of preferred stock and structured debt. Core One currently operates

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### 1. Organization and Basis of Presentation - continued

from three branch office locations: Chicago, Illinois; Pittsburgh, Pennsylvania; and Baltimore, Maryland; with licensing to do business in Florida and South Carolina.

Additionally Rockford, Nanophase, ADEPT and RDT were held as subsidiaries until sold in 2003. Rockford, Nanophase, ADEPT and RDT were never active, held any assets or had any liabilities or operations. These subsidiaries were created for the purpose of developing specific applications from scientific intellectual property. The Company never implemented its plans to develop the scientific intellectual property. All of its scientific intellectual properties, together with certain marketable securities held for sale, were sold in 2003 to a director, in exchange for the return of 62,000 shares of the Company's common stock and the cancellation of \$1,100 in debt.

### Going Concern and Plan of Operations

The accompanying consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern, which contemplates the realization of assets and extinguishment of liabilities in the normal course of business.

As shown in the accompanying financial statements, the Company had a net loss of \$803,670 for the nine months ended September 30, 2005. It has incurred an accumulated deficit of \$11,357,184 and has a deficit of working capital of \$1,701,205 as of September 30, 2005. The ability of the Company to continue as a going concern is dependent on obtaining additional capital and financing and operating at a profitable level. The Company intends to seek additional capital either through debt or equity offerings, or a combination thereof, and to seek acquisitions which will generate sales volume with operating margins sufficient to achieve profitability. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

### Basis of Presentation

The Company has prepared the financial statements on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America. In the opinion of management, all adjustments

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considered necessary for a fair presentation have been included.

### 2. Summary of Significant Accounting Policies

#### Principles of Consolidation

The accompanying consolidated financial statements include the operations, account balances and cash flows of the Company and its wholly owned subsidiaries, Financial Services, Inc., Silverado Mortgage Corporation, and Core One Mortgage, Inc. Intercompany transactions and account balances have been eliminated in consolidation. The operations are consolidated from their respective acquisition dates of November 19, 2002 (Financial Services, Inc.), May 9, 2003 (Silverado Mortgage Corporation) and May 5, 2005 (Core One Mortgage, Inc.).

#### Concentration of Credit Risk

The Company maintains its cash balances in several financial institutions located in California. The balances held are insured by the Federal Deposit

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### 2. Summary of Significant Accounting Policies - continued

Insurance Corporation up to \$100,000. As of September 30, 2005 the Company's account balances did not exceed these limits.

The Company's revenues are concentrated in the mortgage industry which is highly competitive and subject to fluctuations in economic condition. The Company's results of operations, financial condition and business prospects could be materially adversely affected if competition intensifies or if competitors significantly expand their activities in the Company's markets. Fluctuations in interest rates and general economic conditions may also affect the Company's competitive position.

#### Cash and Cash Equivalents

For the purpose of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents.

#### Financial Instruments

Financial instruments consist primarily of cash, investments in marketable securities and obligations under accounts payable and accrued expenses. The carrying amounts of cash, accounts receivable, accounts payable, notes payable and accrued expenses approximate fair value because of the short term maturity of those instruments.

#### Investments

Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, requires that all applicable investments be classified as trading securities, available for sale securities or held to maturity securities. The Company did not have any investments classified as trading securities or held-to-maturity securities. The statement further requires that available for sale securities be reported at fair value, with unrealized gains and losses excluded from earnings but reported in a separate component of stockholders' equity (net of the effect of income taxes)

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until they are sold. At the time of sale, any gains or losses are recognized as a component of operating results.

At September 30, 2005, the Company's investments held for sale were \$0. The Company acquired an investment in Liberty Settlement Services, LLC on May 5, 2005. From that date, forward, 50% of the income is owned by the Company. The Company's share of income through September 30, 2005 is valued at \$51,297 of which \$28,787 was distributed during the third quarter of 2005.

### Furniture and Equipment

Furniture and equipment are carried at cost less accumulated depreciation. Depreciation is provided on the straight-line method over estimated useful lives generally ranging from three to seven years. Intellectual property is carried at cost less valuation impairment expense and is amortized using the straight-line method over its estimated useful life of three years. Leasehold improvements are carried at cost and are amortized over the shorter of their estimated useful lives or the related lease term (including options), generally ranging from one to six years. Expenditures for major renewals that extend useful lives of furniture, equipment and improvements are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. For income tax purposes, depreciation is computed using the modified cost recovery system.

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### 2. Summary of Significant Accounting Policies (continued)

Depreciation expense for the nine months ended September 30, 2005, was \$57,088. Amortization expense for the nine months ended September 30, 2005, was \$174,753.

### Intellectual Property

The Company's intellectual property is comprised of a software platform purchased with Financial Services, Inc. in 2002. The Company periodically evaluates the recoverability of intangible assets and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that an impairment exists. The Company put the software into productive use in October 2004 and began amortizing the asset as of that date.

### Impairment of Long-Lived Assets

On January 1, 2002, the Company adopted SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which requires that long-lived assets, that are to be held and used, will be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

In the event that facts and circumstances indicate that the cost of long-lived assets, primarily intellectual property and patents, may be impaired, the Company performs a recoverability evaluation. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amounts exceed the fair values of the assets. Assets to be disposed of are reported at the lower of carrying value or fair value, less costs of disposal.

### Compensating Absences

Employees of the company are entitled to paid vacation, paid sick days and personal days off, depending on job classification, length of service and other

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factors. It is impracticable to estimate the amount of compensation for future absences, and, accordingly, no liability has been recorded in the accompanying financial statements. The company's policy is to recognize the costs of compensated absences when actually paid to employees.

### Convertible Notes

Statement of Financial Accounting Standards No. 150 (SFAS), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of nonpublic entities.

This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The Company has and will continue to report convertible notes as liabilities.

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## 2. Summary of Significant Accounting Policies (continued)

### Stock-Based Compensation

Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation. The Company periodically issues options to consultants and members of the Board of Directors. The estimated value of these options is determined in accordance with SFAS No. 123 and expensed as the granted options vest to the grantees.

The price of any options granted pursuant to these grants is not to be less than 100 percent of the fair market value of the shares on the date of grant. The options expire one year from date of grant and are immediately vested. There was no charge to expense for the value of the options during the nine months ended September 30, 2005, as no options were issued.

### Revenue Recognition

Sales consist of loans to third party investors in the secondary market. Sales are generally recognized at the time of funding, provided that no significant vendor obligations exist and collections of accounts receivable are probable.

### Advertising

Advertising costs are expensed as incurred. For the nine months ended September 30, 2005, the Company did not incur any advertising costs.

### Research and Development

Expenditures for research activities relating to software development and improvement are charged to operations as incurred.

### Income Taxes

The Company accounts for income taxes under the asset and liability method as

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prescribed by Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. As such, deferred income tax assets and liabilities are recognized for the future tax consequences of the differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Accordingly, actual results could differ from those estimates.

### 3. Intellectual Property

Since its inception, the Company entered into numerous agreements as a result of having acquired certain rights to various complex intellectual scientific properties. The Company periodically analyzes its investments in intellectual property for impairment.

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### 3. Intellectual Property (continued)

During the quarter ended June 30, 2003, in a non-arms length transaction with Robert George Krushinsky, a director of the Company, the Company received 62,000 shares of its own common stock together with cancellation of an outstanding debt in the amount of \$1,100 in exchange for all of the scientific intellectual property assets acquired prior to the acquisition of FSI in November 2002 as well as all shares of Rockford Technology held for sale by the Company.

On November 19, 2002, in connection with the acquisition of Financial Software, Inc., the Company acquired certain software, web sites and intellectual property which can aggregate financial information from a large number of data sources on an individual basis, amalgamate the host of disparate objectives as they relate to a person's financial goals, be they investment or debt related or any combination. This software suite, together with mortgage generation capabilities can create a variety of new and different mortgage, investment or insurance products. The Company recorded the software on its books at the seller's basis of \$1,398,020. The Company engaged an experienced software developer based in Palo Alto, California to perform an independent, third party valuation of the software during 2003.

During the fourth quarter of 2004, Silverado Financial, Inc. began implementing its FinanCenter Software system, but in doing so found that the software was in need of upgrades in both programming and technology. With that in mind, management felt that it was necessary to impair the original valuation of \$1,398,020 down 50% to \$699,010. Additionally, on November 24, 2004 the purchase price of the intellectual property was renegotiated as follows: SRD Technologies (former owner of Financial Services, Inc.), signed a debt cancellation and release agreement which included the release of any and all liabilities owed to SRD Technologies, the relinquishment of 574,953 shares of Silverado Financial, Inc. stock, and a payment for auditing expenses in the amount of \$7,500. An additional 44,000 shares were relinquished from Mike Shultz in the re-negotiation. On the date of the agreement 618,953 shares were valued at \$0.05 a share or \$30,948.

In September 2005, the Company received the remaining 157,131 shares due to

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them. The note payable of \$275,000, with corresponding accrued interest of \$41,047 and \$7,500 in accounts payable have been reversed as of December 31, 2004 with a resulting impairment expense of \$389,753.

The Company placed the software into service in October 2004 and is amortizing the software over a three year period commencing upon the in-service date. Amortization expense for the nine months ended September 30, 2005 was \$174,761. Amortization expense is estimated to be as follows for the years ended December 31:

Year	Amount
-----	-----
2005	\$233,003
2006	233,003
2007	174,761
-----	-----
	\$640,767
	=====

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#### 4. Acquisitions

On November 19, 2002, the Company acquired all of the issued and outstanding shares of Financial Software, Inc. (FSI), a New Jersey corporation engaged in the development of Internet and Intranet financial software in addition to operating several financial industry publishing websites. This acquisition was completed on a share for share exchange basis for 4,400,000 shares of the Company's common stock. FSI was acquired in order to gain access to certain proprietary software products owned by FSI, which the Company intends to further develop and extend into comprehensive mortgage platforms called MortgageCenter and FinanCenter.

Through the acquisition of FSI, the Company acquired assets of \$26,775 in marketable securities, \$1,398,020 in intellectual property (MortgageCenter and FinanCenter software), and \$1,904 in computer equipment. The Company also acquired liabilities of \$61,796 in accounts payable and \$275,000 through the assumption of a note payable.

On May 9, 2003 the Board of Directors approved the acquisition of Silverado Mortgage Corporation (SMC), a mortgage brokerage company, from John Hartman for 729,452 restricted common shares. Mr. Hartman (President of Silverado Financial, Inc.) abstained from the vote. The acquisition was made at a trading value of \$127,654 which was the net asset value of SMC and the average closing bid price of the Company on the prior five trading days. Mr. Hartman's holdings of Silverado Financial, Inc. common stock were 103,511 shares (0.87% of total shares outstanding) prior to acquisition and 832,963 shares (6.59% of total shares outstanding) after the acquisition of SMC, respectively.

Through the acquisition of Silverado Mortgage Corporation, the Company acquired total assets of \$168,233, consisting of \$33,963 in accounts receivable and prepaid expenses, \$49,284 in computers and equipment, and \$84,986 in furniture. The Company also acquired liabilities of \$7,871 in accounts payable and \$32,708 through the assumption of notes payable.

On April 29, 2005 the Board of Directors approved the acquisition of Core One Mortgage, Inc., a mortgage brokerage company and fifty percent of Liberty Settlement Services' future net profits for \$3,000,000 in combination of \$1,000,000 of preferred stock to convert to \$1,000,000 of common stock after December 31, 2005, but not later than January 15, 2006, and a \$2,000,000 note payable with 8% interest, payable in monthly installments of \$52,673.

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Through the acquisition of Core One Mortgage, Inc., the Company acquired total assets of \$3,133,620 consisting of \$129,467 of fixed assets, net of accumulated depreciation, \$5,227 prepaid expense, \$17,400 security deposit and \$2,981,526 in goodwill. The Company also acquired liabilities of \$13,620 in accounts payable and incurred 120,000 in acquisition costs. Results of operations for Core One Mortgage, Inc. are included in the consolidated financial statements as of the purchase date of May 5, 2005.

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#### 4. Acquisitions (continued)

Following are pro forma amounts assuming that the acquisition was made on January 1, 2005:

Net sales	\$ 3,277,062
Cost of sales	508,453
	-----
Gross profit	2,768,609
Operating expenses	
Selling, general and administrative expense	3,176,026
Depreciation expense	231,841
	-----
Total operating expenses	3,407,867
	-----
Operating loss	(639,258)
Other income	
Interest income	13,893
Investment income	51,297
	-----
Total other income	65,190
Loss before taxes	(574,068)
Provision for income taxes	6,581
	-----
Net loss	\$ (580,649)
	=====

#### Contingent Payments

The Company issued \$1,000,000 of convertible preferred stock for the purchase of Core One Mortgage, Inc. as described above. The stock must be converted into common stock after December 31, 2005, but not later than January 15, 2006, at not less than \$1,000,000 worth of the Company's common stock at the closing ask price, as reported by [www.nasdaq.com](http://www.nasdaq.com). Should Core One Mortgage, Inc.'s earnings before interest, taxes and depreciation (EBITDA) for the year ended December 31, 2005 be greater than \$900,000, the convertible preferred stock will be increased to 1.5 times the dollar value in excess of \$900,000. The Company can redeem the convertible preferred stock at any time prior to conversion, for cash payments of the unpaid principal balance due on that date.

#### 5. Goodwill

Goodwill is assigned to specific reporting units and is reviewed for possible impairment at least annually or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount is greater than its fair value. Goodwill of \$2,985,471 arose in connection with the

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acquisition or Core One, Mortgage, Inc. No impairment loss has been recognized in the reporting unit.

### 6. Accounts Payable

As of September 30, 2005, the Company owes its vendors a total of \$289,190, of which approximately \$147,277 was outstanding over ninety days.

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### 7. Equity Advance

As of September 30, 2005, the Company had received advance payments on the issuance of common stock for \$165,500.

### 8. Long-Term Debt

#### Notes Payable

Through the acquisition of Financial Software, Inc., the Company became obligated for the acquired accounts payable in the amount of \$30,000. In June 2003, the Company issued 33,000 shares of stock at a value of \$5,000 and a note payable for \$25,000 in satisfaction of accounts payable to one of the FSI vendors. The note carries interest at 5.0%

	\$	25,000
--	----	--------

On October 11, 2004 John E. Hartman returned 729,452 shares, valued at \$43,767, of Silverado Financial, Inc. stock to allow the Company the capability to issue more shares for financing transactions and services. Silverado Financial, Inc. will satisfy the note obligation with re-issuance of shares and a 5% bonus of 36,472 shares, valued at \$2,188.

		43,767
--	--	--------

During September 2005, Sean E. Radetich loaned the Company \$22,617 to cover operating expenses.

		22,617
--	--	--------

Per the purchase agreement of Core One Mortgage, Inc. on May 5, 2005, the Company issued a note in the amount of \$2,000,000, at 8.00%, with monthly payments of \$62,673, payable over three years, with a final payment of \$491,505 on March 6, 2008, commencing May 6, 2005. As of the financial statement date, \$1,803,114 of the original amount remains and \$506,114 is the current portion.

		1,803,114
		-----

Notes payable - current portion		1,894,498
Notes payable - stockholder		(531,114)
		(66,384)
		-----

Notes payable - long term portion		\$ 1,297,000
		=====

Minimum future commitments under notes payable are as follows for the years ended December 31,

Year	Amount
-----	-----
2005	\$ 214,155



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2006	516,304
2007	559,157
2008	604,882
and thereafter	--
	-----
	\$1,894,498
	=====

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### 8. Long-Term Debt (continued)

#### Warehouse Facility

On September 3, 2004, the Company's wholly owned subsidiary, Silverado Mortgage Corporation signed an agreement for a \$2,000,000 mortgage warehouse and security facility.

The warehouse facility requires a demand note. The demand note, in the event of a default, stipulates that any outstanding balance of the warehouse facility can be called at any time, inclusive of interest. Interest is payable when loans are sold (no later than 45 days) at 4.5% above the one month LIBOR rate. The note is subject to mandatory prepayments and is collateralized by the mortgage loans and other predetermined assets.

As of September 30, 2005 the outstanding balance was \$524,300.

### 9. Operating Lease Commitments

During April 2004, the Company became responsible for a lease for 2,512 square feet in an office building in Pleasanton, California. The lease is for a period of three years ending on May 31, 2007 with an option to renew for an additional three years. The base rental under the lease is \$52,752 per annum (\$4,396 per month) during the first twelve-month period, \$54,259 per annum (\$4,522 per month) for the second twelve-month period and \$55,766 per annum (\$4,647 per month) during the third twelve-month period. The lease provides for the Company to pay its proportionate share of the landlord's common costs.

During September 2004, the Company became responsible for a lease for 6,000 square feet in an office building in Campbell, California. The lease is for a period of three years ending on October 31, 2007. The Company rented more space in the current period resulting in an increase in lease costs and obligations. Because of this, an amendment to the lease went into effect, June 1, 2005, setting the rent at \$160,560 per annum (\$13,380 per month) during the next five month period, \$169,500 (\$14,125 per month) during the subsequent twelve month period and \$178,380 (\$14,865 per month) during the final eleven months. The lease provides for the Company to pay its proportionate share of the landlord's common costs.

During November 2004, the Company became responsible for a lease for 6,000 square feet in an office building in Phoenix, Arizona. The lease is for a period of three years ending on January 31, 2008. The base rental under the lease is \$99,000 per annum (\$8,250 per month) during the first thirty-six month period except the Company shall pay \$2,750 for the first ninety (90) days, \$4,125 for the second ninety (90) days and \$6,875 for the third ninety (90) days of the lease. The lease provides for the Company to pay its proportionate share of the landlord's common costs.

During May 2005, the Company became responsible for a lease for 2,080 square feet in an office building in Walnut Creek, California. The lease period is for

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a period of three years ending on May 31, 2008. The base rental under the lease is \$58,656 per annum (\$4,888 per month) during the first twelve month period, \$59,904 annum the following twelve month period (\$4,992 per month), \$61,152 annum the next twelve month period (\$5,096 per month). The lease provides for the Company to pay its proportionate share of the landlord's common costs.

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### 9. Operating Lease Commitments - (continued)

As a result of the acquisition of Core One Mortgage, Inc., the Company assumed lease obligations for properties in several states. A lease for office space in Libertyville, Illinois for a period of three years ending on May 31, 2007 is \$40,200 per annum (\$3,350 per month) throughout the term of the lease. A lease for office space in Wexford, Pennsylvania for a period of three years ending on September 30, 2008 is \$93,555 per annum (\$7,796 per month) throughout the term of the lease. A lease for office space in Forest Hill Industrial Park, Maryland for a period of three years ending on September 30, 2007 is \$33,000 per annum (\$2,750 per month) throughout the term of the lease.

Lease expense for the nine months ended September 30, 2005 was \$258,500.

Minimum future commitments under all operating leases are as follows for the years ended December 31:

Year	Amount
-----	-----
2005	\$ 141,465
2006	568,522
2007	495,432
2008	120,483
and thereafter	--
	-----
	\$1,325,902
	=====

### 10. Income Taxes

The components of the provision for income tax consist of the following for the nine months ended September 30, 2005:

Current tax expense - state	\$ 1,600
Prior tax expense - state	1,600
Deferred tax benefit:	
Federal	141,933
California	45,058
Change in valuation allowance	(186,991)
	-----
Total deferred tax expense	--
	-----
Provision for income taxes	\$ 3,200
	=====

The Company's effective income tax rate is higher than what would be expected if the federal statutory rate were applied to loss from operations primarily because of net operating losses deductible for financial reporting purposes that are not deductible for tax purposes. A full valuation allowance against the net deferred tax assets was recorded at June 30, 2005, due to the Company's uncertainty as to future realization of income tax loss carryforwards.

A reconciliation of the Company's income tax expense rate to U.S. federal

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statutory rate for the nine months ended September 30, 2005 is as follows:

As of September 30, 2005, the Company had realized federal net operating losses of approximately \$8,825,215. Future realization of the net deferred tax assets is dependent on generating sufficient taxable income prior to their expiration. The net operating losses expire, as follows:

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### 10. Income Taxes (continued)

Expiration	Federal	State	State
	-----	-----	-----
2009	44,994		
2010	379,485	\$2,109,954	
2011	461,101	318,228	
2012	236,028	76,034	
2013	--	522,756	
2014	--	119,873	\$ 389,827
2018	861,526		
2019	603,950		
2020	3,670,269		
2021	578,596		
2022	126,723		
2023	871,260		
2024	991,283		
	-----	-----	-----
	\$8,825,215	\$3,146,845	\$ 389,827
	=====	=====	=====

### 11. Loss Per Share

As of September 30, 2005, there were convertible notes with exercisable warrants outstanding. Outstanding options, warrants and convertible securities to purchase common stock were not considered in the calculation for diluted earnings per share for the nine months ended September 30, 2005, because the effect of their inclusion would be anti-dilutive. A reconciliation of the numerator and denominator of the basic and diluted per share calculations for the loss from continuing operations is as follows:

	Net (Loss)	Basic (Loss) Per Share	Diluted (Loss) Per Share
	-----	-----	-----
Loss	\$ (803,670)	\$ (803,670)	\$ (803,670)
Shares		19,635,524	19,735,524
Per share		\$ (0.04)	\$ (0.04)

### 12. Related Party Transactions

On May 9, 2003 the Board of Directors approved the acquisition of Silverado Mortgage Corporation SMC, a mortgage brokerage company, from John E. Hartman (President of Silverado Financial, Inc.) for 729,452 restricted common shares. Mr. Hartman abstained from the vote. The acquisition was made at a trading value of \$127,654 which was the net asset value of SMC and the average closing bid price of the Company on the prior five trading days. Mr. Hartman's holdings of Silverado Financial, Inc. common stock were 103,511 shares (0.87% of total shares outstanding) prior to acquisition and 832,963 shares (6.59% of total shares outstanding) after the acquisition of SMC, respectively.

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On October 11, 2004 John E. Hartman returned 729,452 shares, valued at \$43,767, of Silverado Financial, Inc. stock to allow the Company the capability to issue more shares for financing transactions and services. Silverado Financial, Inc. will satisfy the note obligation with reissuance of shares and a 5% bonus of 36,472 shares, valued at \$2,188.

During September, 2005 Sean E. Radetich loaned the Company \$22,617 to cover operating expenses.

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### 13. Contingencies

On January 27, 2004 DL Pacific Center LP (DL Pacific) filed a lawsuit for \$40,444 plus costs and attorney's fees against the Company in San Diego County Superior Court. The suit alleges that, after the purchase of San Francisco Funding, Inc. (SFF) in November 2003, the Company assumed SFF's obligations pursuant to DL Pacific's lease with SFF by accepting the benefits of such lease and by negotiating with DL Pacific for amendments to the lease. The purchase was never consummated. Silverado Financial Inc. has agreed to settle the lawsuit for the nuisance value of \$2,500.

Silverado Financial, Inc. has filed a cross-complaint against SFF and its major stockholders, Mr. and Mrs. Daniel Selis, for indemnity for the cost of defending the Vener lawsuit, and punitive damages resulting from breach of contract, fraud and/or interference with the Company's advantageous business relationships.

On May 12, 2004 The Subway.Com filed for arbitration for \$60,000 plus interest against the Company in the state of Florida. The suit claims breach of contract for stock promotion services. The Company believes it has meritorious defense and that no contract was ever consummated. The August 2005 arbitration date has been postponed.

On July 16, 2004, the Company was served with a complaint by the State of California, Department of Industrial Relations on behalf of a former contractor for back wages of \$10,938 and penalties of \$288 for an indeterminate number of days. This case was settled by Silverado on November 21, 2005 for \$10,000 payable in three payments in December 2005 and January 2006.

On August 17, 2005, a former loan advisor filed a lawsuit against the Company claiming he was not paid for \$10,000 in commissions he had earned. The Company has settled out of court agreeing to pay \$1,400 to resolve the dispute.

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

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, INCLUDING, WITHOUT LIMITATION, STATEMENTS REGARDING OUR EXPECTATIONS, BELIEFS, INTENTIONS OR FUTURE STRATEGIES THAT ARE SIGNIFIED BY THE WORDS "EXPECTS", "ANTICIPATES", "INTENDS", "BELIEVES", OR SIMILAR LANGUAGE. SUCH FORWARD-LOOKING STATEMENTS INCLUDE, BUT ARE NOT LIMITED TO, THE SEEKING OF REVENUE PRODUCING ACQUISITIONS, THE DEVELOPMENT PLANS FOR THE TECHNOLOGIES OF THE COMPANY, TRENDS IN THE RESULTS OF OUR DEVELOPMENT, ANTICIPATED DEVELOPMENT PLANS, OPERATING EXPENSES AND OUR ANTICIPATED CAPITAL REQUIREMENTS AND CAPITAL RESOURCES. THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS, UNCERTAINTIES AND OTHER FACTORS. ALL FORWARD-LOOKING STATEMENTS INCLUDED IN THIS DOCUMENT ARE BASED ON INFORMATION AVAILABLE TO THE COMPANY ON THE DATE HEREOF AND SPEAK ONLY AS OF THE DATE HEREOF. THE FACTORS DISCUSSED BELOW UNDER "FORWARD-LOOKING STATEMENTS" AND ELSEWHERE IN THIS QUARTERLY REPORT ON FORM 10-QSB ARE AMONG THOSE FACTORS THAT IN SOME CASES HAVE AFFECTED OUR RESULTS AND

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COULD CAUSE THE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS. IN ADDITION, THE FOLLOWING DISCUSSION IS INTENDED TO PROVIDE AN ANALYSIS OF OUR FINANCIAL CONDITION AND PLAN OF OPERATION AND SHOULD BE READ IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND THE NOTES THERETO.

### MANAGEMENT'S PLAN OF OPERATION

Silverado Financial, Inc. (the "Company", "We", "Us" and "Our") is incorporated under the laws of the State of Nevada and based in Pleasanton, California in the East San Francisco Bay Area. The Company provides first and second mortgage

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

products to borrowers in California and Colorado through its operating subsidiary, Silverado Mortgage Corporation (SMC).

The corporation was initially formed on February 26, 1987 as Toledo Medical Corporation. The name was changed to Almaz Space Corporation on February 9, 1991 and to Ready When You Are Funwear, Inc. on April 14, 1992. On December 30, 1994 a group of individuals acquired control of the Company. On February 17, 1995, they changed the name to Rhombic Corporation. On March 19, 2003, the company changed its name to Silverado Financial, Inc.

In November 2002, the Company acquired Financial Software, Inc. as the first part of its strategy to enter the lucrative consumer finance sector. In May of 2003 the Company acquired Realty Capital Corporation, a California based mortgage brokerage, and renamed the wholly owned subsidiary Silverado Mortgage Corporation in August of 2004.

During the 1st Quarter the company had one wholly owned subsidiary: Silverado Mortgage Corporation ("SMC").

Silverado acquired Financial Software, Inc. on November 19, 2002 in a share for share exchange basis for 4,400,000 shares of common stock. Financial Software, Inc. (FSI), a New Jersey corporation engaged in the development of Internet and Intranet financial software in addition to operating several financial industry publishing websites. Silverado acquired FSI in order to gain access to certain proprietary software products owned by FSI which we intend to further develop and extend into a comprehensive back office platform necessary to accomplish managements business objectives. Financial Software has been merged into Silverado Financial, Inc. effective the first quarter of 2005.

On May 9, 2003, Silverado acquired Realty Capital Corporation in exchange for 729,452 shares of restricted common stock from John E. Hartman, the President and Chief Executive Officer of the Company and a director. The Company was renamed Silverado Mortgage Corporation in August of 2004. SMC operates as a mortgage brokerage and mortgage banking company licensed by the California Department of Real Estate and by the California Department of Corporations as a Consumer Finance Lender. SMC generated all of the Company's 2004 revenue through its offices in Campbell and Pleasanton, California and Phoenix Arizona.

In addition to continuing, and expanding, the operation of SMC, other activities have consisted of developing the business plan, obtaining a warehouse line of credit, raising capital, business plan implementation and recruiting and training sales people. For the year ending December 31, 2004, the Company had revenues of \$919,930, and has expensed operating costs in the amount of \$1,590,650. Historically, the Company has had nominal cash resources and has

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been largely dependent on the direct financial support from a few shareholders, directors and officers along with limited revenue to pay for cash expenditures. In addition, the Company has been dependent on its officers; directors and certain key vendors accepting restricted common stock for their services.

### BUSINESS OF THE ISSUER

#### General

Silverado Financial Incorporated is a mortgage banking company focused on providing non-prime borrowers, individuals who generally do not satisfy the credit, documentation or other underwriting standards set by more traditional sources of mortgage credit, with access to capital for the purchase and

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

refinancing of one to four-family residential properties. The Company originates mortgage loans, which include fixed and adjustable-rate loans, for purposes such as debt consolidation, refinancing, education, home improvement and real estate purchase.

As the primary aspect of the Company's business and finance strategy, Silverado sells its loans to third-party investors (correspondent investors) in the secondary mortgage market. Presently the Company sells its loans through whole loan sales to correspondent investors, but as the Company grows it will dispose of its loan production through a combination of whole loan sales and securitization.

The Company's mortgage business has two principal components. First, Silverado makes mortgage loans to individual borrowers. Each loan is a cash and expense outlay for the Company, because its total cost incurred in originating a loan exceeds the fees it collects at the time it originates the loan. At the time of origination, Silverado either finances the loan by borrowing under a warehouse line of credit, or acts as an agent and brokers the loan to another mortgage lender. Second, the Company sells the loans on a whole-loan basis, and uses the net proceeds from these transactions to repay its warehouse lines of credit and for working capital.

Silverado currently operates 3 offices in California, corporate headquarters and retail sales office in Pleasanton, California, a sales office in Campbell, California, a sales office in Walnut Creek California and a sales office in Phoenix, Arizona.

Because of Silverado's focus on the Non-Prime borrower, and the subsequent growth of that market segment, the Company is largely insulated from interest rate increases unlike many of its competitors in the highly sensitive Prime "A" paper market segment.

#### Strengths and Competitive Advantages

We believe that we have several strengths and competitive advantages that allow us to compete effectively in our business, including:

- o **Low Interest Rate Sensitivity:** Due to Silverado's focus on the non-prime borrower, and the subsequent growth of that market, Silverado is largely insulated from increases in interest rates.

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o Performance-Based Compensation Structure. Our compensation structure helps keep fixed costs at a minimum and allows us to weather industry down-turns.

o Proprietary Training Program. We have developed and implemented a proprietary training program, which broadens the hiring pool and helps to accelerate internal growth.

o Position as a Direct Lender. As the industry consolidates Silverado's position as a direct lender helps it to attract employees and insulates it against the proposed regulatory changes

### Competition

We face competition in the business of originating, purchasing and selling mortgage loans. Our competitors include other consumer finance companies, mortgage banking companies, commercial banks, credit unions, thrift

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

institutions, credit card issuers and insurance finance companies. Other financial institutions have gradually expanded their lending capabilities. Many of these companies have greater access to capital at a cost lower than our cost of capital under our warehouse, aggregation, and asset backed commercial paper facilities. Federally chartered banks and thrifts can preempt some of the state and local lending laws to which we are subject, thereby giving them a competitive advantage. In addition, many of these competitors have considerably greater technical and marketing resources than we have.

Competition among industry participants can take many forms, including convenience in obtaining a loan, customer service, marketing and distribution channels, amount and term of the loan, loan origination fees and interest rates. Additional competition may lower the rates we can charge borrowers, thereby potentially lowering gain on future loan sales and securitizations. In 2004, the most significant form of competition was pricing pressure among mortgage originators. Some of our competitors lowered rates and fees to preserve or expand their market share.

### FORWARD LOOKING STATEMENTS

Certain statements made in this report on Form 10-QSB are "forward looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results implied by such forward looking statements. Although we believe that the expectations reflected in such forward looking statements are based upon reasonable assumptions, our actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference might include: the failure of the registrants efforts to secure additional equity capital, the inability to successfully execute the revised business plan, the success or failure to implement the management to operate possible acquisitions profitably, and the registrant's planned marketing, public relations and promotional campaigns.

### RISK FACTORS

Stockholders and prospective purchasers of our common stock should carefully consider the risks described below before making a decision to buy our common

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stock. If any of the following risks actually occurs, our business could be harmed. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. When determining whether to buy our common stock, stockholders and prospective purchasers should also refer to the other information in this Form 10-K, including our financial statements and the related notes.

A prolonged economic slowdown or a lengthy or severe recession could hurt our operations, particularly if it results in a decline in the real estate market.

The risks associated with our business are more acute during periods of economic slowdown or recession because these periods may be accompanied by decreased demand for consumer credit and declining real estate values. Declining real estate values reduce the ability of borrowers to use home equity to support borrowings because they negatively affect loan-to-value ratios of the home equity collateral. In addition, because we make a substantial number of loans to credit-impaired borrowers, the actual rates of delinquencies, foreclosures and losses on these loans could be higher during economic slowdowns. Any sustained period of increased delinquencies, foreclosures or losses could adversely affect

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

our ability to sell loans, the prices we receive for our loans, the value of our mortgage loans held for investment or our residual interests in securitizations, which could have a material adverse effect on our results of operations, financial condition and business prospects.

Our earnings may decrease because of increases or decreases in interest rates. Our profitability may be directly affected by changes in interest rates. The following are some of the risks we face related to an increase in interest rates:

- o An interest rate increase may affect our earnings by reducing the spread between the interest we receive on our loans and our funding costs.

- o A substantial and sustained increase in interest rates could adversely affect our loan origination volume because refinancing an existing loan would be less attractive and qualifying for a purchase loan may be more difficult.

- o During periods of rising interest rates, the value and profitability of our loans may be negatively affected between the date of origination or purchase and the date we sell or securitize the loan.

- o When and if we securitize loans, the value of residual interests we retain and the income we receive from the securitizations structured as financings are based primarily on the London Inter-Bank Offered Rate ("LIBOR"). This is because the interest on the underlying mortgage loans is based on fixed rates payable on the loans for the first two or three years while the bondholders are generally paid based on an adjustable LIBOR-based yield. An increase in LIBOR reduces the net income we would receive from, and the value of, these mortgage loans and residual interests.

- o Our adjustable-rate mortgage loans have periodic and lifetime interest rate caps above, which the interest rate on the loans may not rise. In the event of general interest rate increases, the rate of interest on these mortgage loans could be limited, while the rate payable on the senior certificates representing interests in a securitization trust into which these loans are sold may be



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uncapped. This would reduce the amount of cash we receive over the life of the loans in securitizations structured as financings and our residual interests, and could require us to reduce the carrying value of our residual interests.

We are also subject to risks from decreasing interest rates. For example, a significant decrease in interest rates could increase the rate at which loans are prepaid, which also could require us to reduce the carrying value of any residual interests. If prepayments were greater than expected, the cash we would receive over the life of our residual interests would be reduced. Higher-than-expected prepayments could also have a negative effect on the value of any servicing portfolio.

Any such changes in interest rates could have a material adverse effect on our results of operations, financial condition and business prospects.

An interruption or reduction in the securitization and whole loan markets could hurt our financial position.

As we implement our plan to become a full service mortgage banking company, we will become increasingly dependent on the securitization market for the sale of our loans because we intend to securitize loans directly in the future and many of the whole loan buyers who purchase loans do so with the intention to

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

securitize them. The securitization market is dependent upon a number of factors, including general economic conditions, conditions in the securities market generally and conditions in the asset-backed securities market specifically. In addition, poor performance of previously securitized loans could harm our access to the securitization market. Accordingly, a decline in the securitization market or a change in the market's demand for loans could have a material adverse effect on our results of operations, financial condition and business prospects.

If we are unable to maintain adequate financing sources, our earnings and our financial position will suffer and jeopardize our ability to continue operations.

We require substantial cash to support our operating activities and growth plans. Our primary sources of cash are profits generated by sales of mortgage products and the sale of our capital stock; however, we intend to generate income from warehouse and aggregation credit facilities, asset-backed commercial paper and the proceeds from the sales and securitizations of loans. We also intend to finance residual interests in securitization transactions using Net Interest Margin, or NIM, structures. As of December 31, 2003, we had no short-term warehouse and aggregation credit facilities or asset-backed commercial paper providing us with any committed or uncommitted borrowing capacity to fund loan originations and purchases pending the pooling and sale of such loans.

On August 11, 2004 our wholly owned subsidiary, Silverado Mortgage Corporation (formerly Realty Capital Corporation) received approval for a \$2,000,000 Mortgage Warehouse and Security Facility. A signed agreement was executed on September 3, 2004 and we started utilizing the warehouse and security facility on November 22, 2004.

During volatile times in the capital and secondary markets, access to warehouse,

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aggregation and residual financing as well as access to the securitization and secondary markets for the sale of loans has been severely constricted. If we are unable to maintain adequate financing or other sources of capital are not available, we would be forced to suspend or curtail our operations, which could have a material adverse effect on our results of operations, financial condition and business prospects.

New legislation could restrict our ability to make mortgage loans, which could adversely impact our earnings.

Several states and cities are considering or have passed laws, regulations or ordinances aimed at curbing predatory lending practices. The federal government is also considering legislative and regulatory proposals in this regard. In general, these proposals involve lowering the existing federal Homeownership and Equity Protection Act thresholds for defining a "high-cost" loan, and establishing enhanced protections and remedies for borrowers who receive such loans. However, many of these laws and rules extend beyond curbing predatory lending practices to restrict commonly accepted lending activities, including some of our planned activities. For example, some of these laws and rules prohibit any form of prepayment charge or severely restrict a borrower's ability to finance the points and fees charged in connection with his or her loan. In addition, some of these laws and regulations provide for extensive assignee liability for warehouse lenders, whole loan buyers and securitization trusts. Because of enhanced risk and for reputation reasons, many whole loan buyers elect not to purchase any loan labeled as a "high cost" loan under any local,

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

state or federal law or regulation. Accordingly, these laws and rules could severely constrict the secondary market for a significant portion of our loan production. This would effectively preclude us from continuing to originate loans that fit within the newly defined thresholds. For example, after the October 1, 2002 effective date of the Georgia Fair Lending Act, many lenders and secondary market buyers refused to finance or purchase Georgia loans. As a result, many companies were forced to cease providing mortgages in Georgia until the law's amendment a few months later. Similar laws have gone into effect in New Jersey, as of November 27, 2003 ("New Jersey Home Ownership Act of 2002"), and in New Mexico, as of January 1, 2004 ("New Mexico Home Loan Protection Act"), that have impacted origination of loans in those states. The potential long-term reduction in loans in New Jersey and in New Mexico could be quite severe. Moreover, some of our competitors who are national banks or federally chartered thrifts may not be subject to these laws and may as a consequence be able to capture market share from us and other lenders. For example, the Office of the Comptroller of the Currency recently issued regulations effective January 7, 2004 that preempt state and local laws that seek to regulate mortgage-lending practices. Passage of such laws could increase compliance costs, reduce fee income and reduce origination volume, all of which would have a material adverse effect on our results of operations, financial condition and business prospects.

We are no longer able to rely on the Alternative Mortgage Transactions Parity Act to preempt certain state law restrictions on prepayment penalties, which could adversely impact our earnings.

The value of a mortgage loan depends, in part, upon the expected period of time that the mortgage loan will be outstanding. If a borrower pays off a mortgage loan in advance of this expected period, the holder of the mortgage loan does not realize the full value expected to be received from the loan. A prepayment

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penalty payable by a borrower who repays a loan earlier than expected helps offset the reduction in value resulting from the early payoff. Consequently, the value of a mortgage loan is enhanced to the extent the loan includes a prepayment penalty, and a mortgage lender can offer a lower interest rate and/or lower loan fees on a loan which has a prepayment penalty. Prepayment penalties are an important feature used to obtain value on loans.

Certain state laws restrict or prohibit prepayment penalties on mortgage loans, and until July 2003, lenders could rely on the federal Alternative Mortgage Transactions Parity Act (the "Parity Act") and related rules issued in the past by the Office of Thrift Supervision (the "OTS") to preempt state limitations on prepayment penalties. The Parity Act was enacted to extend to financial institutions, other than federally chartered depository institutions, the federal preemption that federally chartered depository institutions enjoy. However, on September 25, 2002, the OTS released a new rule that reduced the scope of the Parity Act preemption and, as a result, we are not able to rely on the Parity Act to preempt state restrictions on prepayment penalties. The effective date of the new rule, originally January 1, 2003, was subsequently extended by the OTS until July 1, 2003 in response to concerns from interested parties about the burdens associated with compliance. The elimination of this federal preemption requires us to comply with state restrictions on prepayment penalties. These restrictions prohibit us from charging any prepayment penalty in eight states and limit the amount or other terms and conditions of our prepayment penalties in several other states. This may place us at a competitive disadvantage relative to financial institutions that continue to enjoy federal preemption of such state restrictions. Such institutions are able to charge prepayment penalties without regard to state restrictions and, as a result, may be able to offer loans with interest rate and loan fee structures that are more

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

attractive than the interest rate and loan fee structures that we are able to offer.

The scope of our lending operations exposes us to risks of noncompliance with an increasing and inconsistent body of complex laws and regulations at the federal, state and local levels.

Currently, we are licensed to originate mortgage loans only in California, however we are in the process of applying for licenses to generate loans in all 50 states, and when licensed we will be forced to comply with the laws and regulations, as well as judicial and administrative decisions, for all of these jurisdictions, as well as an extensive body of federal law and regulations. The volume of new or modified laws and regulations has increased in recent years, and, individual cities and counties have begun to enact laws that restrict non-prime loan origination activities in those cities and counties. The laws and regulations of each of these jurisdictions are different, complex and, in some cases, in direct conflict with each other. As our operations continue to grow, it may be more difficult to comprehensively identify, to accurately interpret and to properly program our technology systems and effectively train our personnel with respect to all of these laws and regulations, thereby potentially increasing our exposure to the risks of noncompliance with these laws and regulations.

Our failure to comply with these laws can lead to:

- o civil and criminal liability;

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- o loss of approved status;
- o demands for indemnification or loan repurchases from purchasers of our loans;
- o class action lawsuits; or
- o administrative enforcement actions.

Any of these results could have a material adverse effect on our results of operations, financial condition and business prospects. If warehouse lenders and securitization underwriters face exposure stemming from legal violations committed by the companies to whom they provide financing or underwriting services, this could increase our borrowing costs and negatively affect the market for whole loans and mortgage-backed securities.

In June 2003, a California jury found a warehouse lender and securitization underwriter liable in part for fraud on consumers committed by a lender to whom it provided financing and underwriting services. The jury found that the investment bank was aware of the fraud and substantially assisted the lender in perpetrating the fraud by providing financing and underwriting services that allowed the lender to continue to operate, and held the bank liable for 10% of the plaintiff's damages. This is the first case we know of in, which an investment bank was held partly responsible for violations committed by the bank's mortgage lender customer. If other courts or regulators adopt this theory, investment banks may face increased litigation as they are named as defendants in lawsuits and regulatory actions against the mortgage companies with which they do business. Some investment banks may exit the business, charge more for warehouse lending or reduce the prices they pay for whole loans in order to build in the costs of this potential litigation. This could, in turn, have a negative effect on our results of operations, financial condition and business prospects.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

High delinquencies or losses on mortgage loans in securitizations may decrease cash flows or impair our ability to sell or securitize loans in the future. Loans made to lower credit grade borrowers, including credit-impaired borrowers, entail a higher risk of delinquency and higher losses than loans made to borrowers with better credit. We plan to make a substantial portion of our loans to borrowers who do not qualify for loans from conventional mortgage lenders. No assurance can be given that our underwriting criteria or methods will afford adequate protection against the higher risks associated with loans made to lower credit grade borrowers. We will be subject to risks of default and foreclosure following the sale of loans through securitization. To the extent such losses are greater than expected; the cash flows received through residual interests and from securitizations structured as financings would be reduced. Increased delinquencies or losses may also reduce or eliminate our ability to sell or securitize loans in the future and could have a substantial, material adverse effect on our operations, financial condition and business prospects.

Our inability to realize cash proceeds from loan sales and securitizations in excess of the loan acquisition cost could adversely affect our financial position.

The net cash proceeds received from loan sales consist of the premiums received on sales of loans in excess of the outstanding principal balance, plus the cash proceeds received from securitizations, minus the discounts on any loans that are sold for less than the outstanding principal balance. If we are unable to originate loans at a cost lower than the cash proceeds realized from loan sales, our results of operations, financial condition and business prospects could be materially adversely affected.

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Warehouse and aggregation financing is subject to margin calls based on the lender's opinion of the value of loan collateral. An unanticipated large margin call could adversely affect our liquidity.

The amount of financing we may receive under any warehouse and aggregation-financing agreements depends in large part on the lender's valuation of the mortgage loans that secure the financings. Asset-backed commercial paper facilities have similar provisions. Each such facility provides the lender the right, under certain circumstances, to reevaluate the loan collateral that secures outstanding borrowings at any time. In the event the lender determines that the value of the loan collateral has decreased, it has the right to initiate a margin call. A margin call would require us to provide the lender with additional collateral or to repay a portion of the outstanding borrowings. Any such margin call could have a material adverse effect on our results of operations, financial condition and business prospects.

We face intense competition that could adversely affect our market share and our revenues.

We face intense competition from finance and mortgage banking companies and from Internet-based lending companies. In addition, certain government-sponsored entities, such as Fannie Mae and Freddie Mac, are also expanding their participation in the non-prime mortgage industry. These government-sponsored entities have a size and cost-of-funds advantage that allows them to purchase loans with lower rates or fees than we are willing to offer. While the government-sponsored entities presently do not have the legal authority to originate mortgage loans, including non-prime loans, they do have the authority to buy loans. A material expansion of their involvement in the market to purchase non-prime loans could change the dynamics of the industry by virtue of

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

their sheer size, pricing power and the inherent advantages of a government charter. In addition, if as a result of their purchasing practices, these government-sponsored entities experience significantly higher-than-expected losses; such experience could adversely affect the overall investor perception of the non-prime mortgage industry.

Competitors with lower costs of capital have a competitive advantage over us. In addition, establishing a lending operation such as ours requires a relatively small commitment of capital and human resources. This low barrier to entry permits new competitors to enter our markets quickly and compete with us. This could have a material adverse effect on our results of operations, financial condition and business prospects.

Some thrifts, national banks and their operating subsidiaries are also expanding their lending activities. By virtue of their charters, these institutions are exempt from complying with many of the state and local laws that affect our operations. For example, they can offer loans with prepayment charges in many jurisdictions where we cannot. If more of these federally chartered institutions are able to use their preemptive ability to provide more competitive pricing and terms than we can offer, it could have a material adverse effect on our results of operations, financial condition and business prospects.

The intense competition in the mortgage industry has also led to rapid technological developments, evolving industry standards and frequent releases of

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new products and enhancements. As mortgage products are offered more widely through alternative distribution channels, such as the Internet, we may be required to make significant changes to our information systems to compete effectively. Our inability to continue enhancing our current capabilities, or to adapt to other technological changes in the industry, could have a material adverse effect on our results of operations, financial condition and business prospects.

Our hedging strategies may not be successful in mitigating our risks associated with changes in interest rates.

We intend to use various derivative financial instruments to provide a level of protection against changes in interest rates, but no hedging strategy can protect us completely. When rates change we expect to record a gain or loss on derivatives, which would be offset by an inverse change in the value of loans or residual interests. We cannot assure you, however, that our use of derivatives will offset the risks related to changes in interest rates. It is likely that there will be periods in the future, during which we will incur losses after accounting for our derivative financial instruments. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could actually increase our risk and losses. In addition, hedging strategies involve transaction and other costs. We cannot assure you that our hedging strategy and the derivatives that we use will adequately offset the risk of interest rate volatility or that our hedging transactions will not result in losses.

The complex federal, state and municipal laws governing loan-servicing activities could increase our exposure to the risk of noncompliance.

We intend to service the loan we originate on a nationwide basis. Therefore, we must comply with the laws and regulations, as well as judicial and

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

administrative decisions, of all relevant jurisdictions pertaining to loan servicing, as well as an extensive body of federal laws and regulations. The volume of new or modified laws and regulations has increased in recent years, and, in addition, some individual municipalities have begun to enact laws that restrict loan-servicing activities. The laws and regulations of each of these jurisdictions are different, complex and, in some cases, in direct conflict with each other. As our servicing operations continue to grow, it may be more difficult to comprehensively identify, to accurately interpret and to properly program our technology systems and effectively train our personnel with respect to all of these laws and regulations, thereby potentially increasing our exposure to the risks of noncompliance with the laws and regulations pertaining to loan servicing. Our failure to comply with these laws could lead to, among other things: (i) civil and criminal liability, including potential monetary penalties; (ii) legal defenses causing delaying or otherwise adversely affecting the servicer's ability to enforce loans, or giving the borrower the right to rescind or cancel the loan transaction; (iii) class action lawsuits; and (iv) administrative enforcement actions. This could result in a material adverse effect on our results of operations, financial condition and business prospects.

Any non-prime loans we originate will generally have higher delinquency and default rates, which could result in losses on loans that we are required to

repurchase.

Non-prime mortgage loans generally have higher delinquency and default rates than prime mortgage loans. Delinquency interrupts the flow of projected interest income from a mortgage loan, and default can ultimately lead to a loss if the net realizable value of the real property securing the mortgage loan is insufficient to cover the principal and interest due on the loan. Also, our cost of financing and servicing a delinquent or defaulted loan is generally higher than for a performing loan. We bear the risk of delinquency and default on loans beginning when we originate them. In whole loan sales our risk of delinquency typically only extends to the first payment, but when we securitize we continue to bear some exposure to delinquencies and losses through our residual interests and the loans underlying our on-balance sheet securitization transactions. We are required to establish reserves based on our anticipated delinquencies and losses. We also re-acquire the risks of delinquency and default for loans that we are obligated to repurchase. We attempt to manage these risks with risk-based loan pricing and appropriate underwriting policies and loan collection methods. However, if such policies and methods are insufficient to control our delinquency and default risks and do not result in appropriate loan pricing and appropriate loss reserves, our business, financial condition, liquidity and results of operations could be harmed.

We are subject to losses due to fraudulent and negligent acts on the part of loan applicants, mortgage brokers, other vendors and our employees. When we originate mortgage loans, we rely heavily upon information supplied by third parties including the information contained in the loan application, property appraisal, title information and employment and income documentation. If any of this information is intentionally or negligently misrepresented and such misrepresentation is not detected prior to loan funding, the value of the loan may be significantly lower than expected. Whether a misrepresentation is made by the loan applicant, the mortgage broker, another third party or one of our employees, we generally bear the risk of loss associated with the misrepresentation. A loan subject to a material misrepresentation is typically unsaleable or subject to repurchase if it is sold prior to detection of the misrepresentation, and the persons and entities involved are often difficult to

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

locate and it is often difficult to collect any monetary losses that we have suffered from them.

There are controls and processes designed to help us identify misrepresented information in our loan origination operations. We cannot assure you, however, that we have detected or will detect all misrepresented information in our loan originations.

We may be subject to fines or other penalties based upon the conduct of our independent brokers.

The mortgage brokers from whom we obtain loans have parallel and separate legal obligations to which they are subject. While these laws may not explicitly hold the originating lenders responsible for the legal violations of mortgage brokers, increasingly federal and state agencies have sought to impose such assignee liability. Recently, for example, the United States Federal Trade Commission ("FTC") entered into a settlement agreement with a mortgage lender where the FTC characterized a broker that had placed all of its loan production with a single lender as the "agent" of the lender. The FTC imposed a fine on the

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lender in part because, as "principal," the lender was legally responsible for the mortgage broker's unfair and deceptive acts and practices. The United States Justice Department in the past has sought to hold a non-prime mortgage lender responsible for the pricing practices of its mortgage brokers, alleging that the mortgage lender was directly responsible for the total fees and charges paid by the borrower under the Fair Housing Act even if the lender neither dictated what the mortgage broker could charge nor kept the money for its own account. Accordingly, we may be subject to fines or other penalties based upon the conduct of our independent mortgage brokers.

Our business is dependent upon conditions in California where we conduct a significant amount of our business.

In 2004, 100% of the mortgage loans we originated were secured by property in California. An overall decline in the economy or the residential real estate market, or the occurrence of a natural disaster, such as an earthquake, or a major terrorist attack in California could adversely affect the value of the mortgaged properties in California and increase the risk of delinquency, foreclosure, bankruptcy, or loss on mortgage loans in our portfolio. This would negatively affect our ability to purchase, originate and securitize mortgage loans, which could have a material adverse effect on our business, financial condition and results of operations.

If many of our borrowers become subject to the Soldiers' and Sailors' Civil Relief Act of 1940, as amended our cash flows from our residual securities and our securitizations structured as financings may be adversely affected.

Under the Soldiers' and Sailors' Civil Relief Act of 1940, a borrower who enters military service after the origination of his or her mortgage loan generally may not be charged interest above an annual rate of 6% during the period of the borrower's active duty status. The Act also applies to a borrower who was on reserve status and is called to active duty after origination of the mortgage loan. A prolonged, significant military mobilization as part of the war on terrorism or the war in Iraq could increase the number of the borrowers in our securitized pools who are subject to this Act and thereby reduce the interest payments collected from those borrowers. To the extent the number of borrowers who are subject to this Act is significant, the cash flows we receive from loans underlying our on-balance sheet securitizations and from our residual interests

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

would be reduced, which could cause us to reduce the carrying value of our residual interests and would decrease our earnings. In addition, the Soldiers' and Sailors' Civil Relief Act of 1940, imposes limitations that would impair the ability of the servicer to foreclose on an affected mortgage loan during the borrower's period of active duty status, and under certain circumstances, during an additional three month period thereafter. Any such reduction in our cash flows or impairment in our performance could have a material adverse effect on our results of operations, financial condition and business prospects.

The inability to attract and retain qualified employees could significantly harm our business.

We are dependent on our account executives and retail loan officers to attract borrowers by, among other things, developing relationships with financial institutions, other mortgage companies and brokers, real estate agents, borrowers and others. We believe that these relationships lead to repeat and



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referral business. The market for skilled account executives and loan officers is highly competitive and historically has experienced a high rate of turnover. In addition, if a manager leaves New Century, there is an increased likelihood that other members of his or her team will follow. Competition for qualified account executives and loan officers may lead to increased hiring and retention costs. If we are unable to attract or retain a sufficient number of skilled account executives at manageable costs, we will be unable to continue to originate quality mortgage loans that we are able to sell for a profit, which would have a material adverse effect on our results of operations, financial condition and business prospects.

An interruption in or breach of our information systems may result in lost business.

We rely heavily upon communications and information systems to conduct our business. Any failure or interruption or breach in security of our information systems or the third-party information systems on which we rely could cause underwriting or other delays and could result in fewer loan applications being received, slower processing of applications and reduced efficiency in loan servicing. We are required to comply with significant federal and state regulations with respect to the handling of customer information, and a failure, interruption or breach of our information systems could result in regulatory action and litigation against us. We cannot assure you that such failures or interruptions will not occur or if they do occur that they will be adequately addressed by the third parties or us on which we rely. The occurrence of any failures or interruptions could have a material adverse effect on our results of operations, financial condition and business prospects.

The success and growth of our business will depend upon our ability to adapt to and implement technological changes.

Our mortgage loan origination business is currently dependent upon our ability to effectively interface with our brokers, borrowers and other third parties and to efficiently process loan applications and closings. The origination process is becoming more dependent upon technological advancement, such as the ability to process applications over the Internet, accept electronic signatures, provide process status updates instantly and other customer-expected conveniences that are cost-efficient to our process. In addition, we are in the process of implementing a new loan origination system. Implementing and becoming proficient with the new loan origination system and other new technology will require significant financial and personnel resources. There is no guarantee that the

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

implementation of our new loan origination system or other new technology will be successful. To the extent that we become reliant on any particular technology or technological solution, we may be adversely affected to the extent that such technology or technological solution (i) becomes non-compliant with existing industry standards, (ii) fails to meet or exceed the capabilities of our competitors' equivalent technologies or technological solutions, or (iii) becomes increasingly expensive to service, retain and update. Any failure to acquire technology or technology solutions when necessary could limit our ability to remain competitive in our industry and could also limit our ability to increase the cost-efficiencies of our operating model, which would have a material adverse effect on our results of operations, financial condition and business prospects. We may be required to repurchase mortgage loans or indemnify investors if we breach representations and warranties, which could adversely

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impact our earnings.

When we sell loans, we are required to make customary representations and warranties about such loans to the loan purchaser. Our whole loan sale agreements require us to repurchase or substitute loans in the event we breach a representation or warranty given to the loan purchaser or make a misrepresentation during the mortgage loan origination process. In addition, we may be required to repurchase loans as a result of borrower fraud or in the event of early payment default on a mortgage loan. Likewise, we are required to repurchase or substitute loans if we breach a representation or warranty in connection with our securitizations. The remedies available to a purchaser of mortgage loans are generally broader than those available to us against the originating broker or correspondent. Further, if a purchaser enforces its remedies against us, we may not be able to enforce the remedies we have against the sellers. The repurchased loans typically can only be financed at a steep discount to their repurchase price, if at all. They are also typically sold at a significant discount to the unpaid principal balance. Significant repurchase activity could negatively affect our cash flow and results of operations.

We are exposed to risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to residential properties, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation, and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

Our charter and bylaws and Nevada law contain provisions that could discourage a takeover.

Our amended and restated certificate of incorporation and our amended and restated bylaws include various provisions that could delay, defer or prevent a takeover attempt that may be in the best interest of our stockholders. These provisions include the existence of a classified board of directors, the ability of our board of directors to issue shares of our preferred stock without any

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

further stockholder approval and requirements that (i) our stockholders give advance notice with respect to certain proposals they may wish to present for a stockholder vote, (ii) our stockholders act only at annual or special meetings and (iii) two-thirds of all directors approve a change in the number of directors on our board of directors. Issuance of our preferred stock could discourage bids for the common stock at a premium as well as create a depressive effect on the market price of our common stock.

We are also subject to Nevada General Corporation Law, which could discourage potential acquisition proposals, delay or prevent a change of control and

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prevent changes in our management.

If we do not manage our growth effectively, our financial performance could be harmed.

Rapid growth places, and will continue to place, certain pressures on our management, administrative, operational and financial infrastructure. As of December 31, 2003, we had no employees, as all of our personnel were independent contractors; however, we have recently applied for licensure under the California Department of Corporations as a Consumer Finance Lender and will begin hiring loan executives as employees. Many of these employees have a limited understanding of our systems and controls. The increase in the size of our operations may make it more difficult for us to ensure that we originate quality loans and that we service them effectively. We will need to attract and hire additional sales and management personnel in an intensely competitive hiring environment in order to preserve and increase our market share. At the same time, we will need to continue to upgrade and expand our financial, operational and managerial systems and controls.

Various factors may cause the market price of our common stock to become volatile, which could adversely affect our ability to access the capital markets in the future.

The market price of our common stock may experience fluctuations that are unrelated to our operating performance. In particular, the price of our common stock may be affected by general market price movements as well as developments specifically related to the consumer finance industry and the financial services sector. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts, or a significant reduction in the price of the stock of another participant in the consumer finance industry. This volatility may make it difficult for us to access the capital markets through additional secondary offerings of our common stock, regardless of our financial performance.

### ITEM 3: CONTROLS AND PROCEDURES

a) Evaluation of disclosure controls and procedures. Our Chief Executive Officer, after evaluating the effectiveness of the our "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this annual report (the "Evaluation Date"), has concluded that as of the Evaluation Date, our disclosure controls and procedures were adequate and designed to ensure that material information relating to the Company and our consolidated subsidiaries would be made known to him by others within those entities.

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### ITEM 3: CONTROLS AND PROCEDURES (continued)

(b) Changes in internal control over financial reporting. There were no significant changes in the our internal control over financial reporting during the fourth fiscal quarter that materially affected, or are reasonably likely to materially affect, the our internal control over financial reporting.

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On January 27, 2004 DL Pacific Center LP ("DL Pacific") filed a lawsuit for \$40,444 plus costs and attorney's fees against us in San Diego County Superior Court. The suit alleges that, after we purchased San Francisco Funding, Inc. ("SFF") in November 2003, we assumed SFF's obligations pursuant to DL Pacific's lease with SFF by accepting the benefits of such lease and by negotiating with DL Pacific for amendments to the lease. Silverado has agreed to settle the lawsuit.

On March 9, 2004 Robert E. Vener ("Vener") filed an amendment to his lawsuit for \$7,500 per month from November 2003 to March 2006 plus costs and attorney's fees against us in Marin County Superior Court. The suit alleges that, after we purchased San Francisco Funding, Inc. ("SFF") in November 2003, we assumed SFF's obligations pursuant to Vener's lease with SFF by stating and representing to Vener that we would be responsible for any amounts due from SFF pursuant to the lease, and that Vener relied on our representations by allowing SFF to remain on the premises following SFF's default in the payment of rent on the lease. We have agreed to settle the suit.

We have filed a cross-complaint against SFF and its major stockholder(s) Mr. and Mrs. Daniel Selis, for indemnity for the cost of defending the Vener lawsuit, and punitive damages resulting from breach of contract, fraud and/or interference with our advantageous business relationships because of: (1) SFF's material breaches of the SFF stock purchase agreement and SFF's material misrepresentations to us of SFF's liabilities and obligations, (2) SFF's written false statements to its creditors that we had assumed their debts, and (3) SFF's forwarding of its phone calls to our offices and directing their creditors to call our offices concerning payment of their liabilities and obligations. On May 12, 2004 The Subway. Com filed for Arbitration for \$60,000 plus interest against us in the state of Florida. The suit claims breach of contract for stock promotion services. The Company believes it has meritorious defense and that no contract was ever consummated.

On July 16, 2004, the company was served with a complaint by the State of California, Department of Industrial Relations on behalf of a former contractor for back wages of \$10,937.50 and penalties of \$288.46 for an indeterminate number. It is management's opinion, that we have meritorious defenses based upon the facts, among others, that claimant was acting as an independent contractor who was paid for services performed and her claims are baseless.

On November 24, 2004, SRD Technologies signed a debt cancellation and release agreement which included the release of any and all liabilities owed to SRD Technologies, the relinquishing of 574,953 shares of Silverado Financial, Inc. (SLVO) stock, and a payment to be made by SRD Technologies for auditing expenses in the amount of \$7,500. On the date of the agreement the 574,953 shares were worth \$.05 a share or \$28,748. The affect on our books would be the release of debt in the form of a note payable in the amount of \$275,000 plus accrued interest of \$41,047. The \$7,500 payment would reduce our payable to our auditors and there would be a reduction in shares issued and outstanding.

On November 24, 2004, John Shebanow signed a general release agreement, which included the relinquishing of any and all shares of Silverado Financial, Inc. held by himself (575,870 shares), friends and family and releases any and all of

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Silverado Financials liability to Mr. Shebanow on the date of the agreement the 575,870 shares were worth \$0.05 a share or \$28,794. The affect on our books would be a reduction in accounts payable of approximately \$20,660 and a reduction in the number of shares issued and outstanding.

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### ITEM 2. CHANGES IN SECURITIES

On January 14, 2005 the Company issued 410,000 S-8 shares in payment for legal services and as retainer for future service to out corporate attorney David Kahn. The value of the securities at the time was \$37,000. The company also issued 32,675 shares to Martin Fisher for work on the Company's software the value of the shares was \$\$2,950. We also issued 20,750 shares to Allen Suzuki for accounting services the value of the shares was \$1,867.50. Juan Negrón was issued 4,572 S-8 share in payment for work on computers and network infrastructure at a value of \$1000.00.

On January 14, 2005 the Company issued 10,000 shares of restricted stock in exchange for furniture and fixtures for the Phoenix, Arizona of to Justin Berry.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

None.

### ITEM 5. OTHER INFORMATION

Not applicable.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

31.1 Certificate of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

#### (b) Reports on Form 8-K

Report on Form 8-K filed with the Security and Exchange Commission on May 17, 2005 reporting Acquisition of CoreOne Mortgage and Liberty Settlement.

### SIGNATURES

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

/s/ John E. Hartman

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By: John E. Hartman  
President, Chief Executive Officer  
& Interim Chief Financial Officer

Date: December 22, 2005